Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 1: The Logic of Collective Action

I. The Many Meanings of Efficiency
   A. The *Merriam-Webster College Dictionary* defines "efficiency" as "effective operation as measured by a comparison of production with cost (as in energy, time, and money)."
   B. Economists occasionally do use "efficiency" in the dictionary sense - ratio of the value of output to input or something similar.
   C. But normally they use it in quite different ways, and unfortunately often equivocate between the various uses.
   D. The two most common uses in economics are:
      1. Pareto efficiency
      2. Kaldor-Hicks (or cost-benefit) efficiency

II. Pareto Efficiency, I
   A. Most of the famous theorems in welfare economics discuss Pareto efficiency.
   B. A situation is **Pareto efficient** iff the only way to make one person better off is to make another person worse off.
   C. Similarly, a **Pareto improvement** is any change that makes someone better off without making anyone else worse off.
   D. In theory, it is quite possible that people will voice objections to Pareto improvements for *strategic reasons*. So it is <u>not</u> equivalent to a demonstrated preference standard.
   E. In a highly stylized theoretical setting, Pareto improvements are conceivable. Ex: If everyone has identical preferences and endowments.

III. Pareto Efficiency, II
   A. Even so, there is a strong argument that, in the real world:
      1. Everything is Pareto efficient.
      2. Pareto improvements are impossible.
   B. Why? Almost any change hurts someone, and it is highly unlikely in practice that literally everyone can be compensated, that absolutely no one will be missed.
   C. Ex: I buy your watch. How will we compensate everyone who might have asked you the time?
   D. Rothbard's strange variant: Only count "demonstrated preferences." Then Pareto improvements happen all the time. But especially for an Austrian, this is bizarrely behavioristic.
   E. More fruitful variant: Analyze the Pareto efficiency of ex ante *rules* instead of ex post results. (This is the key intuition behind a lot of constitutional economics). But even then, someone is very likely to slip through the cracks.

IV. Kaldor-Hicks Efficiency, I

A. In practice, then, economists almost always switch to Kaldor-Hicks efficiency, aka "cost-benefit efficiency."

B. A situation is **Kaldor-Hicks efficient** iff the dollar value of social resources is maximized.

C. A **Kaldor-Hicks improvement** is any change than *raises* the dollar value of social resources.

D. Every Kaldor-Hicks efficient situation is Pareto efficient, but most Pareto efficient situations are NOT Kaldor-Hicks efficient.

E. Ex: You value a watch at $20, I value it at $30, the strangers you will encounter value my having the watch at $.10, the (different) strangers I will encounter value my having the watch at $.10.

1. If I have the watch, the situation is K-H and Pareto efficient.
2. If you have the watch, the situation is Pareto but not K-H efficient. Social value on the watch rises from $20.10 to $30.10, but your time-askers lose $.10.

F. Every Pareto improvement is a Kaldor-Hicks improvement, but most Kaldor-Hicks improvements are not Pareto improvements. (Return to above example).

G. K-H efficiency is often described as "potentially Pareto efficient" because if the value of social resources rises, then (assuming perfect continuity), you *could* compensate all of the losers by sharing the gain in surplus.

H. But what exactly does this "could" mean? Essentially, you could if transactions costs of arranging compensation were zero.

I. This bothers many people - why shouldn't the transactions costs count just as much as other costs? Ultimately, though, this is just another way of saying that Kaldor-Hicks improvements don't have to be Pareto improvements. No one said ever said they were.

1. When you judge whether something is a K-H improvement, you do count the transactions costs for the move itself.

V. Kaldor-Hicks Efficiency, II

A. K-H efficiency naturally gives rise to another concept: deadweight costs. If the value of social resources is not maximized, deadweight costs exist.

B. Everyone knows that you can *transfer* resources from one person to another. That's obvious.

C. Economists' marginal product: It is far less obvious that resources can be destroyed, leaving *no one* better off.

D. Ex: Piracy. It is obvious that pirates transfer treasure from victims to themselves. The deadweight costs of piracy are far less obvious. What are they? Treasure that gets lost in the fight, damage to ships, lost lives on both sides, etc.

1. The point is **not** that pirates make themselves worse off by piracy. At least ex ante, they don't. The point is that the pirates only gain a fraction of what the non-pirates lose.

2. This assumes, of course, that people don't *directly enjoy* fighting, watching gold sink to the ocean floor, etc.

E. Economists often criticize non-economists for thinking in terms of a "fixed pie" of wealth. In this sense, economists are more optimistic than the public. However, a corollary is that the pie can also *shrink*! In this sense, economists are more pessimistic than the public. With a fixed pie of resources, conflict at least has to benefit SOMEONE.

VI. The Comparative Institutions Approach and "Second Best"

A. Demsetz famously complained about the "Nirvana fallacy" - doing (K-H) efficiency comparisons while selectively relaxing important constraints.

B. His target was old-style welfare economics, where the solution to any market shortcoming was government involvement. The shortcomings of government - and even its basic overhead - were almost never factored in.

C. Classic example: P>MC.

1. Standard solution: Impose P=MC price control.
2. Secondary problem: With fixed costs, firms now lose money.
3. Standard solution: Subsidize them.
4. Tertiary problem: How can the subsidies be funded?
5. Standard solution: Taxes
6. But what about the DW cost of the taxes?!
7. And of course this still overlooks a wealth of problems. What *is* MC? Who awards subsidies, and what are their incentives? Etc.

D. Demsetz's lesson is that economists should use a "comparative institutions approach." Nothing in the real world is perfectly efficient. What fails least badly?

1. The Tale of the Emperor

E. When you add more constraints to a standard problem, the original optimum is usually no longer feasible. Economists frequently refer to the original optimum as a "first-best solution," and the new, worse optimum as a "second-best solution."

F. Example: Pricing subject to a P=AC constraint in a decreasing cost industry.

VII. Private Versus Social Benefits and Costs

A. Foundation of welfare economics: realization that private and social effects can differ.

B. Ex: A thief clearly enjoys private benefits of stealing. But looking only at the thief's benefits misses the big picture: The thief makes himself better off by making others worse off.

C. Ex: A person driving a polluting car is better off from driving, but that person isn't the only one who consumes the exhaust.

1. Contrast with: Worker safety trade-offs.

D. How to measure "social benefits"? The same way we always do: willingness to pay. If some people benefit and some people suffer from a policy, the net social benefits are the SUM of the private benefits (positive and negative).

VIII. Negative Externalities

A. The basic idea of the tragedy of the commons is that when no one owns a resource, it gets over-used.

B. Question: What exactly does "over-use" mean in economic terms?

C. Answer: It means that there are costly side effects, or "negative externalities," that selfish agents don't factor into their decisions.

D. How do you diagram negative externalities? In addition to the demand curve, draw a "social benefits curve." With negative externalities, the social benefits curve will lie <u>below</u> the demand curve.

E. Social optimum is at the intersection of the social benefits curve and the supply curve, but market equilibrium is at the intersection of the demand curve and the supply curve.

F. If the social optimum differs from the market equilibrium, it is typically called a "market failure."

G. Negative externalities are also often called "public bads," especially when the externalities are large relative to demand (so the socially optimal quantity is close to zero).

H. Ex: Pollution. People value better air, but polluters normally have no incentive to care.

I. The key: non-excludability.

1. There is no feasible way to exclude non-payers from the cleaner air.
2. Since you do not *have to* pay to use it, selfish people *will not* pay to use it.
3. And if no one will pay for it, why would selfish producers provide it?

IX. Positive Externalities

A. Positive externalities are the other side of the coin. Positive externalities are **beneficial** side effects that selfish agents don't factor into their decisions.

B. How to diagram? Draw a social benefits curve *above* the demand curve.

C. Positive externalities are also often called "public goods," especially when the externalities are large relative to demand (so the equilibrium quantity is close to zero).

D. Non-excludability is once again the key. If you can't exclude, there is no incentive to pay; if there is no incentive to pay, there is no incentive to produce.

E. Ex: Defense. People value defense, but how can suppliers be paid to provide it?

X. Understanding Externalities

A. David Friedman's two caveats:
    1. Must distinguish benefits from external benefits. (E.g. education).
    2. Must include both positive and negative externalities in your calculations. (Important case: "pecuniary externalities").
B. Further insight from Friedman: "It is easy to misinterpret problems of market failure as unfairness rather than inefficiency... The problem with public goods is not that one person pays for what someone else gets but that nobody pays and nobody gets, even though the good is worth more that it would cost to produce."

XI. Bad but Popular Examples; Good but Unpopular Examples
A. Some popular and plausible examples:
    1. Air pollution
    2. National defense
    3. Highways and roads (especially local roads)
    4. Law enforcement (especially victimless crimes)
B. Some popular but dubious examples:
    1. Education
    2. Health and safety
    3. Fire
    4. R&D
C. Some unpopular but plausible examples (depending on the society):
    1. Censorship
    2. Persecution of religious minorities...

XII. Fallacies of Group Action
A. Generalization of public goods theory: People often think in terms of **groups** acting to promote their *group interests*, just as individuals promote their self-interest.
    1. Workers/capitalists
    2. Women (and men?)
    3. Environment
B. But this is a fallacy of composition. Just because all members of group X would benefit if all members did something, it does **not** follow that it benefits any *individual* member to do so.
C. Ex: Suppose one worker decides to just stay home and watch TV while the other workers foment revolution.
    1. Case 1: Revolution succeeds, all workers (supposedly) enjoy a brave new world - including the couch potato.
    2. Case 2: Revolution fails, all workers continue to suffer under the capitalist system - but at least the couch potato got to watch some amusing television programming.
D. We do need to be careful before we assert that there is no selfish reason to contribute. Frequently there are "byproducts" and other "selective incentives" that make contribution selfishly optimal.
    1. Ex: Trotsky on military discipline

XIII. Individual Impact: Probability and Magnitude

A. Saying that "The same thing will happen whatever you do" is admittedly an overstatement. More precisely, "*About* the same thing will *probably* happen whatever you do."

B. In other words, you have to look at the **probability** you make a difference and **magnitude** of that difference, then weigh it against the cost of acting.

C. For example, it is possible that if you join the revolution, you will change the entire course of history. Possible, but not likely!

D. More relevant to public choice: the probability a vote matters and the magnitude of its impact.

E. Voting increases the probability that your favored candidates wins, but how much does it increase that probability?

F. And even if your candidate does win as a result of your vote, how much will policy change?

XIV. Calculating the Probability of Decisiveness, I: Mathematics

A. When does a vote matter? At least in most systems, it only matters if it "flips" the outcome of the election.

B. This can only happen if the winner wins by a single vote. In that case, each voter is "**decisive**"; if one person decided differently, the outcome would change.

C. In all *other* cases, the voter is **not** decisive; the outcome would not change if one person decided differently.

D. It is obvious that the probability of casting the decisive vote in a large electorate is extremely small. The 2000 election does not refute this. Losing by 100 or 1000 votes is a long way from losing by 1 vote!

1. You might however say that Bush did win by a single vote on the Supreme Court! But that is an electorate with only 9 voters.

E. There is a technical formula for "guesstimating" the probability of decisiveness using the *binomial formula*. (Brennan and Lomasky)

F. Suppose there are (2n+1) voters asked to vote for or against a policy.

1. Note: Assuming an odd number of voters avoids the picky problem of ties.

G. Then the probability that YOU are the decisive voter is the probability that exactly n voters out of the 2n voters other than yourself vote "for."

H. Now suppose that everyone but yourself votes "for" with probability p - and "against" with probability (1-p).

I. Then using the binomial theorem: $probability(tie) = \frac{1}{\sqrt{\pi n}}\left(4p - 4p^2\right)^n$

J. From this formula, we can see that the probability of a tie falls when the number of voters goes up. Why?

1. $\frac{1}{\sqrt{\pi n}}$ gets smaller as n gets larger
2. $\left(4p - 4p^2\right)$ is less or equal to 1. When you raise a number less than 1 to a larger power, it must get smaller.

K. This formula also says that as the probability of voter support goes above or below .5, the probability of a tie falls. Why?
1. When p=0, $\left(4p - 4p^2\right) = 0$; when p=1, $\left(4p - 4p^2\right) = 0$ too. In between p=0 and p=1, this term rises to a peak of $\left(4p - 4p^2\right) = 1$ when p=.5, then falls.

L. Intuitively, the more lop-sided opinion on a topic is, the less likely there is to be a tie. If everyone agrees, a tie is impossible.

XV. Calculating the Probability of Decisiveness, II: Examples

A. Let's work through some examples. Remember that the number of voters is (2n+1), not n.

B. Example #1: The close tenure vote. n=10, p=.5.

$$probability(tie) = \frac{1}{\sqrt{10\pi}}\left(4*.5 - 4*.25\right)^{10} = \frac{1}{5.60}\left(1\right)^{10} = \frac{1}{5.60} = .178$$, or 17.8%.

C. Example #2: The close county election. n=5,000, p=.51.

$$probability(tie) = \frac{1}{\sqrt{5000\pi}}\left(4*.51 - 4*.2601\right)^{5000} = \frac{1}{125}\left(.9996\right)^{5000} = \frac{1}{125}.1353 = .0011,$$

or a little more than 1-in-1000.

D. Example #3: The moderately close county election. n=5000, p=.53.

$$probability(tie) = \frac{1}{\sqrt{5000\pi}}\left(4*.53 - 4*.2809\right)^{5000} = \frac{1}{125}\left(.9964\right)^{5000} = \frac{1}{125}1.47*10^{-8} = 1.18*10^{-10}$$

, a little less than 1-in-8 billion.

E. Example #4: The moderately close state election. n=2,000,000, p=.51.

$$probability(tie) = \frac{1}{\sqrt{2{,}000{,}000\pi}}\left(4*.51 - 4*.2601\right)^{2{,}000{,}000} = \frac{1}{2507}\left(.9996\right)^{2{,}000{,}000},$$

a chance smaller than 1 in 10^{-100}! (My calculator just says 0).

F. Upshot: For virtually any real-world election, the probability of casting the decisive vote is not just small; it is normally *infinitesimal*. The extreme observation that "You <u>will</u> not affect the outcome of an election by voting" is true for all practical purposes.

XVI. Empirical Evidence on Collective Action Problems

A. One way to get a feel for the logic of collective action is to see how little participation in politics there is. Survey of adult Americans from Dye and Zeigler:

Activity	%
Run for public office	<1
Active in parties and campaigns	4-5
Make campaign contribution	10
Wear button or bumper sticker	15
Write or call a public official	17-20
Belong to organization	30-33
Talk politics to others	30-35
Vote	30-55

B. Many experiments have been run to help improve our understanding of collective action problems.
   1. Part of the design: Rule out "selective incentives" accounts of apparently unselfish behavior.

C. Standard design:
   1. I hand out a roll of 100 pennies to each person in the class.
   2. Then, people are allowed to secretly put any number of their pennies into a jar.
   3. You personally get to keep the pennies you *don't* put in the jar.
   4. I count the number of pennies in the jar; then I distribute **twice** that many pennies to the class, with each person getting the same share.

D. What maximizes the total income of the class? 100% donation by everyone!

E. What maximizes your private income (given 3 or more players)? 0% donation!

F. The first couple of times you do an experiment like this, you typically get moderate to high levels of donation - 50-80%.

G. Donation levels usually fall as you repeat the experiment with the same group. After a while, donation levels often bottom out at around 20%.
   1. For practical reasons, experiments usually only last a day or less. So we can still speculate about what would happen if people played this game 10 times a day for a year.

H. Donation levels usually decline as the number of participants rises.

I. The less secrecy there is, the higher the level of donation.

J. Conclusion: The "logic of collective action" appears to exaggerate the degree of human selfishness, but cooperation in these experiments is still far below the group-income-maximizing level.

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Week 2: Voting, I: The Basics

I. Rational, Instrumental Voting
   A. Let us begin with two standard assumptions about voters. We will think about relaxing these in the second part of the course, but for now we will stick with them.
   B. Assumption #1: Rational expectations. Voters are often wrong, but their errors balance out to zero.
   C. Assumption #2: Instrumental goals. Voters care about nothing except the policies they get. They aren't interested in personalities, entertainment, impressing their friends with their social conscience, etc.
   D. Neither of these require that voters be selfish. They might be rational, instrumental voters who care only about the liberalism/conservatism of policy, for example.

II. Single-Peaked Preferences
   A. Next, let us assume that voters' preferences are "single-peaked." This means that voters have an "ideal point" (aka "bliss point"), and their utility declines monotonically as policy moves away from it.
   B. For example, one voter's ideal point might be a world where people are allowed to own any weapon up to and including a machine gun. This voter would be less happy in *both*:
      1. A world where fewer weapons were legal (e.g. where the semi-automatic gun is the most dangerous legal weapon).
      2. A world where more weapons are legal (e.g. artillery, tanks, nuclear bombs).
   C. Aren't <u>all</u> preferences "single-peaked"? Probably not. A classic example involves a wealthy parent. If spending on education is high, she sends her kids to public school. But otherwise she sends them to private school, and gets no benefit from education spending. So her preferences would look like this:
      1. #1 pick: high spending
      2. #2 pick: low spending
      3. #3 pick: medium spending

III. Two-Party, Winner-Take-All Elections
   A. Suppose we have a two-party (or two-candidate) election. Voters care about and are perfectly informed about party positions on exactly one issue: liberalism versus conservatism.
   B. The electoral rule is "winner-takes-all" - whoever gets more votes wins.
      1. Picky point - ties. When in doubt, assume ties are resolving by flipping a coin.

C. Assumption about party/candidate motivation: They want to win, and care more about that than everything else put together.
D. The two parties compete in exactly one way: By taking a stand on the issue.
E. Imagine graphing the distribution of voter ideal points. (Non-normality is OK).
F. The electorate may be divided into three groups: those who definitely vote for the more liberal party, those who definitely vote for the more conservative party, and the people in the middle, who pick whichever party is closer to them.

IV. Political Competition and Platform Convergence, I
A. Question: How can you get more votes?
B. Answer: Move to the center. You don't lose any of the extreme votes, and get more of the "swing" votes.
C. In equilibrium, parties' platforms cannot be different, because both parties gain votes by moving closer to each other. $P_D = P_R$.
1. So you can't have an equilibrium where one party gets more than 50% of the votes. You can always win 50% by simply offering exactly the same platform as your competitor.
D. Thus, equilibrium platforms "converge" - both parties offer the same policy. But to what?
E. Could the equilibrium platform ever be one where both parties are above the median of the distribution of voter preferences? No. Why? Because one party would get more than 50% of the votes by moving a little closer to the median. So $P_i \leq P_{med}$.
F. Could the equilibrium platform ever be one where both parties are below the median of the distribution of voter preferences? No, for the same reason. So $P_i \geq P_{med}$.
G. Could the equilibrium platform *be* the median of the distribution? Yes! If both parties are at the median, then staying there gets you 50% of the votes, but moving a little to the left or right gets you *fewer* than 50%.
H. Thus, we arrive at the famous **Median Voter Theorem**: $P_D = P_R = P_{med}$. Given the preceding assumptions, both parties offer platforms identical to the bliss point of the median voter.

V. Voter Participation and Franchise Restrictions
A. There are many factors that affect participation: age, education, what's on the ballot... even the weather.
B. If *proportional* amounts of all political persuasions don't vote, the median stays the same, and so does the electoral outcome.
C. But if participation changes in a disproportionate way, this changes the median, and thereby changes the nature of the winning platform.
D. There are also legal restrictions on voting.
1. Non-citizens normally can't vote at all.

2. Citizens have to register in advance to vote.
3. Non-residents in a state can't vote in that state.
4. Convicted felons and children can't vote.

E. In the past, there were other legal restrictions on the franchise.
1. Non-property-holders
2. Non-whites
3. Women
4. 18-21 year-olds

F. In the past, some countries (like Sweden) also had "plural voting," with extra votes for the aristocracy. Until 1949, Great Britain had plural votes for the well-educated.

G. Corporations have voting proportional to shares ownership, and turnout of small share-holders is typically very low. Thus, the median corporate voter is usually a large shareholder with a big stake in the company's financial success.

VI. The Effect of Fringe Parties

A. In many cases, we see people with extreme preferences deciding not to vote because "their" candidate is an unprincipled "sell-out."

B. Fringe, "extremist" parties do much the same thing. For example, if a far-left Green Party exists, then the Democrats have to worry about two things:
1. Extremists stay home
2. Extremists vote Green

C. If extremists drop out *irrevocably*, and no one else has a chance of joining them, this moves the median voter - and both parties - in the opposite direction! If the 5% of most-left-wing Democrats vote Green, the median of the remaining voters shifts to the right.

D. If extremists drop out *conditional* on "their" party's position, it induces platform divergence. Real-world parties have to trade-off extra moderate votes for foregone extremist votes.

VII. Multi-Peaked Preferences and Intransitivity

A. With multi-peaked preferences, the analysis of elections becomes far more complicated because electoral outcomes may cease to be *transitive*.

B. Transitivity seems like a trivial assumption for individual choice, and for the most part it is. (Though there are many experiments that "trick" people into making intransitive choices).

C. If someone has intransitive preferences, it is unclear what they would choose. You could also become a "money pump."

D. Key conclusion: With multi-peaked preferences, electoral outcomes can be intransitive, even though no individual voter has intransitive preferences!

E. *Proof by example*. Going back to the school case, imagine we've got 3 voters.

F. Voter #1's preference ordering: {high, low, medium}

G. Voter #2's preference ordering: {medium, high, low}

H. Voter #3's preference ordering: {low, medium, high}
I. Imagine giving this 3-person electorate two choices at a time.
    1. High versus low: 2 for, 1 against
    2. Low versus medium: 2 for, 1 against
    3. Medium versus high: 2 for, 1 against
J. Notice: High beats low, low beats medium, and medium beats high!
K. For many, this example shows that the "will of the people" may be meaningless. What level of education spending does "the people" "will" in this example?

VIII. Multiple Voting Dimensions
A. The Median Voter Theorem only strictly holds if there is a single issue.
B. If there are two or more issues that parties take stands on, but only one election, there is no guarantee that the median voter's preference will prefer on *any* issue.
C. Moreover, even with single-peaked preferences, multiple voting dimensions make it possible for voting cycles to arise.
D. At this point, you might say: "But **all** real-world elections have multiple issues. So the Median Voter Theorem is useless."
E. Possibly so. But as we shall see, there is considerable empirical evidence that platforms empirically boil down to a single dimension - in the U.S., position on the liberal-conservative spectrum.

IX. Tiebout and Inter-Governmental Competition; Perverse Incentives
A. For sub-national democracies, the “median voter” may be even more endogenous than you think: People can move to the jurisdictions where they are relatively close to the median voter, mitigating many complaints about majority rule.
B. The economist Tiebout went further, suggesting that democracy at the local level is superfluous.
C. Why? Because you can think about local governments as perfectly competitive suppliers of local public goods.
    1. If the benefit and tax package in a local area is unattractive, residents move away to other localities with more attractive benefit/tax packages. Thus, on the local level, politicians face economic competition from other localities, as well as political competition from other politicians.
    2. If there are decreasing returns to scale, localities can sub-divide to the efficient level.
D. Upshot: So even if you have doubts about the efficiency of democracy, you might still conclude that local governments work well.
E. One big problem with this argument: It assumes that competition between non-profits works just like competition between for profits. Two problems:
    1. Problem #1: Lack of incentives - politicians don't get paid more when the local economy does better

2. Problem #2: Perverse incentives - their lives may be easier when things don't go well
3. The case of school choice

X. Federalism: For and Against
   A. Within any nation, there are normally districts, states, or other "sub"-governments.
   B. Definition: The more independent and powerful these sub-governments compared to the central government, the more "federalist" they are.
   C. There are many popular arguments in favor of federalism that sound a lot like standard economic arguments:
      1. Benefits of competition (Tiebout)
      2. Diversity of tastes
      3. Level of innovation
   D. However, throughout this century the U.S. has generally moved to a lower degree of federalism – heavily encourage by a complex system of grants.
   E. Economic rationales?
      1. Externalities (e.g. cross-state pollution)
      2. Cost savings of uniformity
   F. Classic inter-state externality argument: "The race to the bottom." States allegedly competitively cut welfare spending to encourage recipients to leave the state.
   G. Then again, you might view "The race to the bottom" as a pejorative way of describing the competitive outcome, and federal grants as a grand effort to eliminate inter-state competition.
   H. Application: The race to the top? The case of law enforcement.
   I. Question: Why doesn't Tiebout competition prevent redistribution from e.g. the childless to families, or from business to residential real estate owners?

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 3: Voting, II: Information and Bargaining

I. The Economics of Imperfect Information
   A. Probability language allows us to **quantify uncertainty**. Even though people rarely put a precise number on each event, they almost always have some probabilities in the back of their minds.
   B. When people are asked difficult questions, they often say "I don't know." But what if they HAD to guess? In real life you must.
   C. Common sophism: "No one can 'know' X."
      1. If this means "No one can know X **with certainty**," then it's obvious but uninteresting.
      2. If this means "No one has any idea at all about X," then it is clearly false.
   D. *Search theory* is the most general theory of economic action under uncertainty.
   E. Basic assumptions of search theory:
      1. More time and effort spent "searching" increase your probability of successful discovery.
      2. Searching ability differs between people.
      3. People can make a reasonable guess about the probabilities of different events and their ability to influence those probabilities.
   F. Main conclusion: People keep searching until E(MB)=E(MC).

II. Political Knowledge and Rational Ignorance
   A. How much do voters know about politics? Search theory suggests that we look at the marginal cost and expected marginal gain of acquiring political knowledge.
   B. Easy part: The marginal cost is whatever time you would have to spend reading the newspaper, watching the news, going to politicians' websites, etc.
   C. Harder part: What are the marginal benefits of political knowledge?
   D. Naive answer: The marginal benefits are better government performance stemming from a more informed electorate.
   E. The naive answer is false because it ignores the logic of collective action. For all practical purposes, the MB of political information is 0.
   F. With positive MC and 0 MB, what is the privately optimal quantity of political information to acquire? None. Hence the concept of **rational ignorance**. When knowledge gives you no practical benefit, and time is money, ignorance (the decision not to acquire knowledge) is rational.
   G. So why do voters know anything at all?

1. "Off-label" benefits - not looking stupid in front of your boss
2. Negative cost - curiosity ("politics is fun"); ubiquity of information

III. Empirical Evidence on Political Knowledge

A. Are voters really "rationally ignorant" with regard to politics? Yes.

B. From Dye and Zeigler: Quiz of adult Americans finds that...

Item	**%**
Know President's term is 4 years	94
Can name governor of home state	89
Can name vice president	78
Know which party has U.S. House majority	69
Know there are two U.S. senators per state	52
Can name their Congress member	46
Aware Bill of Rights is first ten amendments to U.S. Constitution	41
Can name both of their U.S. senators	39
Can name current U.S. secretary of state	34
Know term of U.S. House members is 2 years	30
Can name one of their state senators	28

C. Moving to specific policies, voters look far worse; once you reach foreign policy, the level of ignorance is shocking.

D. Voters are however fairly able to correctly answer questions about affairs, scandals, personalities, pets, and so on.

E. If voters' goal is to pick sensible policies, this seems like a crazy way to allocate mental resources.

F. We will be exploring the practical significance of voter ignorance throughout the course. For now, it is worth pointing out two things:

1. People are rational ignorant about many things besides politics. I am rationally ignorant about car mechanics, the activities of the firms I invest in, and so on. My performance on exams about these subjects would also be "shockingly low."
2. For my car or my portfolio, I can just look at the bottom line. Does my car work? What has my rate of return been? A key question to explore as we go on: Do voters have a similar bottom line to check – and do they check it?

IV. Informed Voting as a Public Good

A. The preceding argument only shows that it is *privately* optimal to know little about politics: If *you* weigh *your* costs and *your* benefits, it doesn't help *you*.

B. Acquiring political information appears to be a public good. Society benefits when the electorate is more informed, since sensible policies are more likely to prevail. But these benefits go to the informed and uninformed alike, leaving no private incentive to gather information.

C. What could be done to raise the level of voter information?

1. The popular but costly way: Subsidize information (public service ads, etc.)
2. The unpopular but cheap way: Franchise restrictions

V. Explaining Variation in Political Knowledge
   A. Some econometrics from Delli Carpini and Keeter.
   B. As usual, the claim that "everyone is knowledgeable about something and has something to contribute" is false. Political knowledge of all sorts is highly correlated: People who know a lot about foreign policy usually know a lot about domestic policy, the Constitution, etc.
   C. The strongest predictor of political knowledge is education - not income.
   D. Interesting factoid: Even though education levels greatly increased over the last 50 years, political knowledge scores remained quite constant.
      1. This suggests that education might merely be a proxy for IQ (though by many measures that's risen too).
      2. Alternately, TV and other forms of entertainment might have counterbalanced rising education levels.
   E. One alternative to voter competency testing, then would simply be to restrict the vote to college graduates. This would drastically raise voters' average information levels.
   F. Probably the second-best predictor of political knowledge, controlling for other variables, is gender. Males out-perform females on tests of political knowledge, even when their education, income, age, and other characteristics are the same.

VI. Voter Ignorance, Principal-Agent Problems, and Optimal Punishment
   A. The politician-voter relationship is easy to analyze as a principal-agent problem. The voters are principals - they want politicians to do a good job, keep their promises, etc. Politicians are the agents with their own agenda.
   B. Simple model: politician does what voter wants iff: $B_v > B_s - pD$, where B_v are the benefits a politician gets from doing what voters want, B_s are the benefits of shirking, p is the probability of being caught shirking, and D is the punishment for shirking.
   C. Many believe that rational ignorance allows politicians to shamelessly and repeatedly violate voter trust.
   D. But as Becker observed, when information is available but costly, a natural way to align incentives is *random monitoring combined with harsh punishment*. Just set $D \geq \frac{(B_s - B_p)}{p}$.
   E. Ex: If the media catches a politician taking a $1 bribe, voters could decide to never vote for him again, or even give him jail time.
   F. Something to think about: Politicians seem far more likely to ruin their careers with a slip of the tongue, an affair, youthful drug use,

petty bribery, or other indiscretions than by aggressively pursuing foolish policies - or even breaking campaign promises.

G. Main point: Theoretically, even rationally ignorant voters remain able to control politicians. They could just massively punish all observed dishonesty.

H. What about “buck-passing?” Simple: When in doubt, blame the top.

VII. The Principle of Aggregation

A. A basic principle of statistics is the Law of Large Numbers: random errors tend to "cancel each other out" (in percentage terms).

B. In voting theory, this observation is often called "the principle of aggregation."

C. Some aggregation examples

1. Exams
2. Altruism experiments
3. Public opinion on NATO

VIII. Voter Ignorance and the "Miracle of Aggregation"

A. A number of economists and political scientists admit the ignorance of individual voters, but still defend the quality of the **electorate's** decisions using the principle of aggregation.

B. The argument:

1. Individual voters are poorly informed, and thus their votes are highly random.
2. But elections are based on *aggregate* opinions of millions of voters.
3. Thus, even if there is a large component of randomness in individual voting, the principle of aggregation ensures, for all practical purposes, that outcomes still make sense.

C. Suppose that 90% of all voters are uninformed and vote randomly. The remaining 10% are perfectly informed. Who wins? *Whoever has the support of a majority of the well-informed.*

D. This result has been named "the miracle of aggregation." It seems *miraculous* because it implies that a highly uninformed electorate may - at the aggregate level - act "as if" it were perfectly informed.

E. If true, this is an amazing result. But as we shall see, it hinges critically on the assumption that errors are not systematic.

IX. Uncertainty and Platform Convergence

A. Suppose that *politicians* are uncertain about the exact location of the median voter. What then?

B. If politicians care solely about winning, they go wherever they think the median voter is *most likely* to be located.

C. However, if politicians care about both winning and policy, uncertainty gives them some slack. With full certainty, you either compromise your principles or lose. With some uncertainty, in contrast, you can make a trade-off between your probability of winning and your ideological purity.

D. If the two parties have opposing ideologies, then uncertainty provokes each to move somewhat away from the position they believe the median voter is most likely to hold.

E. This allows for a moderate degree of platform divergence, as each party lowers its chance of winning in order to be true to their cause.

X. Divergence Between Median and Mean Preferences on a Single Dimension

A. Politicians cater exclusively to the median voter when:

1. There is one voting dimension,
2. preferences are single-peaked,
3. and politicians have no uncertainty about voter preferences.

B. Question: Is this an efficient outcome?

C. Answer: In general, no. The efficient outcome is for politicians to cater to the **mean** preference.

D. Why? Total surplus is given by $\sum_{i=1}^{N} s_i$. This equals $\bar{s}N$, average surplus multiplied by the number of people. If the number of voters is fixed, then, total surplus reaches its maximum when you maximize <u>average</u> surplus.

E. Special case: Median and mean preference are identical.

F. Intuition: Under democracy, a vote is a vote; there is no incentive to care about the *intensity of preferences*.

G. In contrast, in markets, intensities matter because people express their wants in dollars, not merely a for/against vote.

H. This is a major inefficiency built into democracy: It treats all preferences equally, even when some are vastly more intense.

XI. Log-Rolling, Bargaining, and the Coase Theorem

A. The Coase Theorem holds for all bargaining, including political bargaining (aka "log-rolling").

B. Main unusual feature of political bargaining: You don't need unanimous consent for a bargain!

C. Election rules create the "initial endowments," the status quo from which bargaining starts.

D. The **Mean Voter Theorem**: with zero transactions costs, political bargaining implements the <u>mean</u> voter preference on any number of issues, even if preferences are not single-peaked.

E. *Bargaining on a Single Issue*: The Coase Theorem implies that log-rolling can take care of the divergence between median and mean preferences.

F. Median voter has the power to pick the "initial endowment" from which bargaining begins. But it remains possible for the minority to "bribe" the majority to switch to a different policy.

G. *Bargaining on Multiple Issues*: Even if median and mean preferences are identical for each issue, democracy need not yield the efficient result if there is one election over multiple issues.

H. But log-rolling across issues once again makes it possible to reach the efficient outcome.

I. *Bargaining Around Intransitivity*: Social intransitivity ultimately stems from ignoring preference intensities. There can be only one option that maximizes surplus. But - without bargaining - voting is a poor method for reaching that point, because it only asks about ordinal preferences, not dollar values.

J. Return to the school spending example:
   1. Voter #1's surplus: {high - $1000, low - $400, medium - $0}
   2. Voter #2's surplus: {medium - $500, high - $250, low - $0}
   3. Voter #3's surplus: {low- $300, medium - $250, high - $200}

K. Recall that under majority rule, high beats low, low beats medium, and medium beats high.

L. Summing total surplus for each option: {high - $1450, medium - $750, low - $700}. High spending unambiguously generates more surplus even though pair wise voting is intransitive.

M. Suppose you begin by voting on medium versus high. Medium wins. With bargaining, though, Voter #1 can "bribe" Voters #2 and #3 to increase spending, perhaps by agreeing to a tax on luxury cars to raise extra school revenue.

XII. Pork Barrel Politics

A. Some economists doubt the wonders of log-rolling. In particular, there are recurring criticisms of "pork barrel" spending, where all legislators swap votes to fund inefficient projects in their home districts.
   1. Examples: Military bases, roads, museums, other infrastructure.

B. The usual story is that all legislators have to participate in the scramble for "pork" because if representatives from one district/state hold back, the money just goes to other districts/states.

C. Two alternative versions:
   1. Politicians want to win popularity by loudly "doing something" for their constituents.
   2. Politicians want to secretly pay off special interests without *losing* their popularity with voters.

D. Note: Rational ignorance cuts against the first and for the second.

E. On either of these account, the intuition is that restraining spending is a public good; the federal budget suffers from a "tragedy of the commons."

F. Puzzle: Why bargain to inefficient outcomes when you could bargain to efficient ones?

G. If you are trying to win popularity, wouldn't voters prefer a tax refund to inefficient programs? If so, why not have the omnibus repeal bill, as with base closings?

H. If you're just trying to buy support from special interests, recall that rationally ignorant voters may be able to keep politicians in line with threats of severe punishment.

XIII. Restrictions on Political Competition: Supermajority Rules, Term Limits, Spending Limits

A. So far we've implicitly assumed that politicians compete without restriction, and that whoever gets more votes wins.

B. But major political changes often require supermajority support, and elections have been increasingly regulated over the past few decades.

C. Restriction #1: Supermajority rules. Like other voting rules, these shift the "initial endowments" for political bargaining.

D. Without bargaining, supermajority rules could easily lead to highly inefficient outcomes.

1. Question: When would supermajority rules without bargaining be efficiency enhancing?

E. With bargaining, however, supermajority rules merely shift the distribution of political "wealth," putting a lot of power in the hands of those who want to block change. This doesn't mean change won't happen, only that it may be necessary to "buy off" opponents.

F. Restriction #2: Term limits. Restricting the total number of terms a politician may serve in a given office.

G. Obvious argument against term limits: It limits voter choice, and magnifies the "end-game problem." If a candidate would have won an election, but can't run due to term limits, voters have to settle for their second choice.

1. "We already have term limits. They're called elections."

H. Arguments for? The main one is probably "incumbency advantage." An inferior incumbent is somehow able to beat a superior challenger.

I. A more specific complaint is that incumbents are more strongly under the influence of special interests. But why don't voters just take this drawback into account?

J. Empirical studies of term limits have quite mixed results. Some find evidence of intensified end-game problems, others of better performance.

1. One GMU dissertation found that term limits make government grow. Note that there are at least two ways to interpret this result.

K. Restriction #3: Spending limits. Restricting the amount candidates and their supporters are allowed to spend on campaigns.

L. Obvious argument against spending limits: Advertising is just information. How are voters supposed to decide without it?

1. Also: If you believe in incumbency advantage, the well-funded challenger may be the only counter-balance.

M. Empirical studies of spending limits rarely find them to be beneficial. This is complicated by choice of metric: Why should we think that "closer" elections are better to begin with?

N. While restrictions supposedly aim at "making democracy work better," they often seem to assume irrational voters. (More on this later).

O. Leaving aside the effect on politicians, what about **policy**? The effects of supermajority rules are fairly clear. But would term and/or spending limits change what government does? In what direction? Wouldn't someone else just offer the same platform?

Table 4.1 Regression Analyses of Knowledge Domains

Variable	Rules of the Game	Substance	People and Parties	Gender	Party	People
(scale)	(0–22)	(0–18)	(0–11)	(0–4)	(0–5)	(0–6)
Follow politics	0.44	0.53	0.27	0.01	0.14	0.13
	.11*	.15***	.08*	.01	.07	.07
Education	0.86	0.72	0.63	0.14	0.33	0.30
	.29****	.28****	28****	.20****	26****	.23****
Internal efficacy	0.40	0.27	−0.04	0.09	−0.02	−0 01
	.13***	.10**	−.02	11*	−.02	− 01
Discuss politics	0.37	0.41	0.24	−0.00	0.13	0.11
	.11**	.14***	.09*	−.00	.09*	08
Income	0 24	0.20	0.13	0.04	0.06	0.07
	.07*	.07*	05	06	.04	05
Other source: newsmagazines	0.69	0.63	0.38	0.04	0 08	0.30
	.08*	.08*	.06	.02	.02	.08*
Read news in newspaper	−0 00	−0.01	0.05	−0.01	0 01	0 04
	− 00	−.02	.14****	−.02	.05	.19****
Sex (female)	−1.22	−1.76	−0.76	−0.04	−0.29	−0.47
	−.16****	−.27****	−.13****	−.02	−.09**	− 14****

Table 4.1 Regression Analyses of Knowledge Domains (*continued*)

Variable	Rules of the Game	Substance	People and Parties	Gender	Party	People
(scale)	(0–22)	(0–18)	(0–11)	(0–4)	(0–5)	(0–6)
Other source: radio	0.89	0.23	0.79	0.11	0.30	0.50
	.09**	.03	.11***	.05	.07*	.12***
Party ID strength	−0.37	−0.09	−0.25	−0.04	0.20	0.04
	−.10**	−.03	−.09**	−.04	.12***	.03
Region (South)	−0.23	−0.01	−0.35	−0.02	−0.04	−0.31
	−.03	−.02	−.06	−.01	−.01	−.09**
Watch TV news	−0.01	−0.01	−0.00	−0.01	−0.00	−0.00
	−.02	−.02	−.01	−.05	−.00	−.01
Race (black)	−2.28	−2.10	−1.48	−0.08	−0.89	−0.59
	−.18****	−.19****	−.15****	−.03	−.16****	−.11**
Trust	−0.06	−0.29	−0.27	−0.02	−0.11	−0.16
	−.01	−.04	−.05	−.01	−.03	−.05
Age	0.02	0.02	0.07	0.00	0.04	0.02
	.07	.12***	.39****	.05	.45****	.24****
Civics instruction	0.23	0.01	−0.01	0.01	−0.05	0.05
	.05	.00	−.00	.01	−.02	.02
r^2	.42	.48	.50	.08	.41	.38
Standard error of the regression	2.89	2.33	2.04	.88	1.27	1.30

Source: 1989 Survey of Political Knowledge
Note: Top entry in each cell is the unstandardized regression coefficient (*b*). Bottom entry is the standardized coefficient (beta).
*p <.05. **p <.01. ***p <.001. ****p <.0001.

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 4: Voter Motivation, I: Selfish, Group, and Sociotropic Voting

I. Is the Median Voter Model Correct?
   I. In order to determine whether or not the median voter model is correct, we must first find out "What voters want."
   J. Once we know what voters want, we can see whether actual policy conforms to the policy preferences of the median voter.
   K. Probably the most popular account of voter motivation is that voters are essentially **self-interested**.
   L. Economists typically think this, but so do many political scientists, journalists, and "men in the street."
   M. Example #1: "Rich people vote Republican, and poor people vote Democratic, because Republicans favor lower taxes and lower spending on redistribution than Democrats."
   N. Example #2: "Blacks were treated worse under Jim Crow because they weren't allowed to vote. Politicians didn't worry about losing their votes for racist policies."
   O. Example #3: "People opposed to conservation laws must own stock in the timber industry."

II. Defining the Self-Interested Voter Hypothesis (SIVH)
   A. There is a danger of tautology here: Is all behavior "self-interested" by definition? Was Mother Theresa self-interested?
   B. Throughout this course, I will only use the term "self-interest" in the falsifiable, ordinary language sense of *directly* valuing only one's *own* material well-being, health, safety, comfort, and so on. Two provisos:
      1. I interpret "people are self-interested" as "on average, people are at least 95% selfish," not "all people are 100% selfish."
      2. Drawing on evolutionary psychology, I interpret altruism towards blood relatives in proportion to shared genes as self-interest.
   C. The self-interested voter hypothesis (SIVH) can then be defined as the hypothesis that *political beliefs and actions of ordinary citizens are self-interested in the preceding sense*.

III. The Meltzer-Richards Model
   A. A simple formal model the captures the standard implications of the SIVH is Meltzer and Richards' "A Rational Theory of the Size of Government."
   B. Basic assumptions of M&R:
      1. Proportional taxes

2. Flat welfare payment goes to everyone (as in a negative income tax)
3. Taxes and welfare affect behavior in standard ways
4. Everyone votes for the candidate that promises them the highest net income
5. Standard MVT holds

C. Implications: Politics is constrained class struggle. There is a battle between rich and poor. But even the poor do not want full equality because this would make them poorer too by eliminating all incentives.
1. Similarly, even the rich may want some redistribution to keep crime down, prevent revolution, etc.

D. For example, in the M&R model, Bill Gates would want a low tax rate, because he pays a proportional tax but collects no welfare.

E. A welfare recipient would want higher taxes. But certainly not 100%, because then no one would want to produce the goods the welfare recipient intends to consume.

F. Simple M&R story suggests you should be able to roughly slice the income distribution into two political factions: the rich and the poor.

G. What wins in equilibrium? There is positive redistribution as long as mean income exceeds median income.

H. They argue that their model explains the expansion of government. As the franchise expanded, so has the divergence between median voter income and mean voter income. Poorer voters, in their rational self-interest, request higher taxes and more redistribution when asked.

I. In M&R model, redistribution is not a product of special interest lobbying, economic confusion, or altruism.

J. In spite of its Chicago stamp, people across the political spectrum, across disciplines, and even non-academics frequently think in terms of the M&R model.

IV. Empirical Evidence on the SIVH

A. There is an enormous literature on the SIVH in general, and M&R-type thinking in particular.

B. Many of these tests - particularly those performed by economists - rely on *aggregate* data. Peltzman (1985) is a classic paper in this tradition.

C. Examples:
1. Are poorer ethnicities more Democratic?
2. Are richer Congressional districts more conservative?
3. Do SS payments rise when a higher percentage of the elderly vote?

D. The results on these sorts of tests are mixed, and there is a lot of interpretive ad hocery.
1. Ex: “Liberalism as a normal good”

E. Tests on aggregate data do reveal something, but are clearly inferior to tests that rely on data about *individuals'* political beliefs and their personal characteristics (income, education, race, age, etc.) relevant to self-interest.
    1. Political scientists pay far more attention to this sort of evidence.
F. Amazing and important conclusion: the SIVH flops. You can find some sporadic and debatable evidence for self-interested political beliefs, but that is about it.
G. Consider the case of party identification. Conventional wisdom tells us that "the poor" are Democrats and "the rich" are Republicans.
H. In fact, the rich are only slightly more likely to be Republicans than Democrats. (Factoids from the SAEE).
    1. Race matters far more than income: High-income blacks are much more likely to be Democrats than white minimum wage workers.
    2. Gender also dwarfs the effect of income: a man earning $25,000 per year is about as likely to be a Democrat as a women earning $100,000 per year.
I. The SIVH fails badly for individual issues as well.
    1. Unemployment policy - The unemployed not much more in favor of relief measures.
    2. National health insurance - The rich and people in good health are about as in favor.
    3. Busing - Childless whites are as opposed as whites with children.
    4. Crime - Crime victims and residents in dangerous neighborhoods are not much more likely to favor severe anti-crime measures.
    5. Social Security and Medicare- The elderly are if anything slightly less in favor than the young.
    6. Abortion - Men are slightly more pro-choice than women.
J. The SIVH fails for government spending, but has some moderate support for taxes.
    1. People expecting large tax savings from Proposition 13 were more likely to support it.
    2. But recipients of government services and government employees were about as likely to support Prop. 13 as anyone else.
K. The SIVH fails for potential death in combat! Relatives and friends of military personnel in Vietnam were more in favor of the war than the rest of the population. Similarly, draft-age males support the draft as strongly as other people.
    1. Marginal evidence for SIVH - exact draft age.
L. Best example of a strong self-interest effect: Smoking!

1. Even though smokers and non-smokers are demographically similar, non-smokers are much more in favor of restrictions on smoking.
2. The heavier the smoker, the stronger the opposition.
3. Only 13.9% of people who "never smoked" supported fewer restrictions, compared to 61.5% of "heavy smokers."

M. Overall, this body of evidence can only be described as revolutionary. It is very hard to argue against it, and it means that most of what people think and write about politics is wrong. Thousands of articles - and millions of conversations - have been a big waste of time because no one bothered to examine the empirical evidence.

N. Moreover, the empirical evidence is intuitively plausible. Are your richer friends really the Republicans, and your poorer friends the Democrats? Can you find any connection at all? It isn't easy.

O. Thus, tests of the Median Voter Hypothesis that assume voters are self-interested are almost bound to fail. Why? If voters are not self-interested, then the failure of policy and the median voter's self-interest to "match" proves nothing.

V. Sociotropic Voting

A. One major alternative to the SIVH, popular among many political scientists, is called "sociotropic voting."

B. Sociotropic voting means voting for policies that maximize "social welfare" or something along those lines.

C. Sociotropic voting is introspectively plausible and works in some interesting empirical tests.

D. Ex: Good economic conditions make politicians more popular. But what matters is mostly **overall** economic conditions, not those of the individual respondent.

E. But it does little to explain voter *disagreement*. If everyone wants to maximize "social welfare," why don't they all vote the same way? In contrast, the SIVH has a ready explanation for disagreement.

F. What would the M&R model predict if voters were sociotropic? Taken literally, it predicts full consensus.

1. Where would the consensus lie? It depends on the deadweight costs of taxation and welfare, the shape of the utility function, initial endowments, etc.

VI. Group-Interested Voting

A. While the SIVH fails badly, there is strong evidence for *group*-interested voting.

B. What's the difference? If a policy hurts you but helps your "group," how do you vote and think? If you go with the group, your voting is group-interested, not self-interested.

C. Ex: The black millionaire. Democrats favor higher and more progressive taxes (which hurts the millionaire a lot), but also care more about the plight of blacks (which does virtually nothing for the millionaire; no one will discriminate against *him*). If self-interested, he would vote Republican; if group-interested, he would vote Democratic.

D. Much of the superficially plausible evidence for self-interested voting turns out to be group-interested when you look more deeply.

E. Ex: Jewish support for Israel.

F. The income-party correlation is stronger in other countries than in the U.S. But perhaps this too actually reflects group-interest. Workers might identify with "the working class," to take one obvious example.

1. Interesting test to try: How many people would switch parties after winning the Lottery?

G. Group-interested voting gives a better theory of disagreement than sociotropic voting. People vote differently because the groups they belong to differ, and groups have divergent interests.

H. Moreover, most people identify with more than one group, and to varying degrees. Classic example: Religious workers in countries with major anti-clerical socialist movements.

I. The group-interest model works in a lot of different countries and time periods. Defining the relevant groups provides some empirical "wiggle room," but not that much.

VII. Case Study: The Determinants of Party Identification, I

A. What happens if you use basic econometrics on data from the General Social Survey to try to sort out the determinants of party identification? N≈49,000 for 1972-2010, so focus on magnitudes, not t-stats.

B. Linear probability model: Predict the probability of being a Democrat or being a Republican conditional on your personal characteristics.

C. What if you ignore ideology, and try to predict party identification using only real income (in 1986 dollars), education (in years), race, sex (1=male, 2=female), age, and year?

D. [Table 1a&1b]

1. *Income*. Income matters in the expected direction for Republicans, but the magnitudes is tiny. If real income rises by 10%, P(Rep) rises by 0.34%.
2. *Education*. A year of education makes people .8 percentage-point more Republican and .5 percentage-points less Democratic. (Remember this is all years)
3. *Race*. Blacks are massively more likely to be Democrats (+35 percentage-points) and less likely to be Republicans (-22 percentage-points). The same pattern holds – albeit more moderately – for members of "other races."

4. *Gender*. Females are markedly more likely to be Democrats (5.6 percentage points).
5. *Age*. Older people are a little more likely to be *both* Democrats and Republicans. (Remember independents are the omitted category).
6. *Year/1000*. The population has grown less Democratic and more Republican over time.

E. What does all this show?
1. Strong evidence for group-interested voting, with race being the main group of interest.
2. Self-interest plays a marginal role at most.

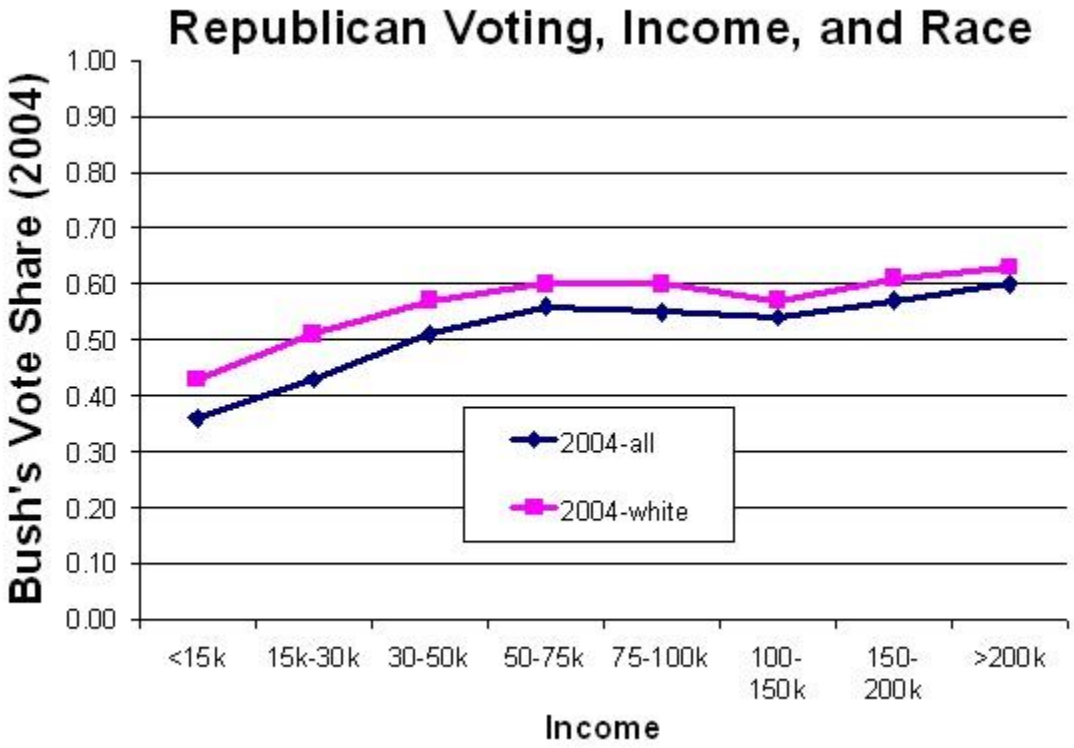
VIII. Rejoinders

A. Most economists would strongly resist my empirical summary. Why?
B. Objection 1: Empirical measures of self-interest are highly imperfect. Why assume "the rich" and "the poor" have common interests in begin with?
C. Ex: Maybe black millionaires rely heavily on government contracts.
D. Objection 2: Incidence complicates matters further. In theory, progressive taxes might actually be paid by the poor.
E. Ex: Maybe regulation actually hurts the poor more than the rich.
F. How convincing are these objections? To my mind, not very. They cut both ways: If measurement error and policy incidence are that ambiguous, we shouldn't take the studies confirming the SIVH seriously either.
G. Another example: The Kenny and Lott study of women's suffrage.
H. Further complication: Magnitudes. Maybe Democrats are better for women, but does a male-female partisan gap equal to the $25k-$100k partisan gap make sense?

IX. Gelman on Income and Voting

A. In *Red State, Blue State, Rich State, Poor State*, Andrew Gelman seems to argue in favor of a sophisticated version of the SIVH.
B. At the state level, the correlation between Democratic vote share and income is actually positive.
C. But this is only aggregate data. When you look at individual data, higher income predicts more Republican voting.
D. This effect gets stronger if you look at the data state-by-state. States change the intercept and the slope, but the slope almost always has the sign predicted by the SIVH. "Income matters, but so does geography."
E. The slope is *steeper* in lower-income states. In CT, it's almost flat.
F. But how much do these results really support the SIVH? The findings on state effects support a *group*-interest story. Furthermore, Gelman admits that about *half* of the effect of income goes away if you omit black voters from the analysis – further evidence of group-interest effects.

G. Furthermore, in absolute terms the slope Gelman finds for income is small. For white voters, Republican voting is perfectly flat for incomes from 30k to 150k – you can quintuple income without changing a thing.



H. Note further that the brackets do not contain equal fractions of the population! The appearance of a pattern largely stems from the 8% of voters with incomes under 15k, and the 3% with incomes over 200k.

X. The SIVH Versus the Logic of Collective Action

A. How is all this unselfish voting possible? It seems to conflict with the logic of collective action - people sacrifice their own political interests without hope of compensation.

B. But this impression is misleading. Why? Precisely because one vote is extraordinarily unlikely to change an electoral outcome, it is very safe to vote against your own interests!

C. Ex: When Barbara Streisand votes for a candidate that will charge her $2 M more in taxes, is that equivalent to giving $2 M to charity?

D. Of course not. Her vote won't change the election's outcome. If the Democrat wins, she has to pay, but *he would have won - and she would have to pay - anyway*! So the MC of voting Democratic is not $2 M, but $2 M times the probability that she casts the decisive vote. Even if that were a high 1-in-2 M, her expected cost of voting Democratic would only be $1.00.

E. The logic of collective action cuts two ways. It makes people unwilling to contribute serious effort for political change. But it also makes people unafraid of voting contrary to their own interests.

Table 1a: Conditional Probability of Being a Democrat

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	-.003	.002	-.007	.005	-1.451	.147
EDUC	-.005	.001	-.030	.005	-6.156	.000
BLACK	.354	.007	.236	.004	53.303	.000
OTHRACE	.124	.010	.057	.004	12.757	.000
SEX	.056	.004	.058	.004	13.402	.000
AGE	.003	.000	.097	.004	21.861	.000
YEARA	-3.825	.194	-.090	.005	-19.740	.000
Constant	7.819	.385			20.308	.000

Table 1b: Conditional Probability of Being a Republican

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.034	.002	.075	.005	15.529	.000
EDUC	.008	.001	.057	.005	11.591	.000
BLACK	-.216	.006	-.158	.004	-35.071	.000
OTHRACE	-.148	.009	-.074	.005	-16.407	.000
SEX	-.008	.004	-.009	.004	-2.016	.044
AGE	.002	.000	.056	.005	12.441	.000
YEARA	1.529	.180	.039	.005	8.488	.000
Constant	-3.245	.358			-9.070	.000

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 5: Voter Motivation, II: Ideological Voting

I. Factor Analysis
   A. One statistical technique social scientists outside of economics use a great deal is *factor analysis*.
   B. The main idea of factor analysis: reducing a lot of variables to a smaller number of "summary" variables, aka "factors" or "dimensions."
   C. The classic example: intelligence testing. A test has 100 items. Is it possible to extract a smaller number of summary variables?
   D. Yes. In fact, factor analysis on variables related to cognitive ability normally finds ONE over-riding factor (called *g* for "general intelligence"). Cognitive ability is essentially "one-dimensional."
   E. Performance on individual test items can be seen as a function of *g* plus noise. The greater the predictive power of *g*, the higher we say the item's *g-loading* is.
      1. Ex: Analogies have a higher g-loading than pure memory tasks.
   F. Factor analysis in no way guarantees the existence of a single over-riding factor. For example, on personality tests, factor analysis normally extracts FIVE unrelated factors.
   G. Factors do not label themselves. Ordinary language terms are convenient, though occasionally misleading.
      1. Ex: OCEAN
   H. On purely random data, no factors would emerge.

II. The Dimensionality of U.S. Political Opinion
   A. There are many different ways to analyze political beliefs.
      1. Libertarian-statist spectrum
      2. Christian-secular spectrum
   B. What can factor analysis tell us about the dimensionality of U.S. political opinion?
   C. Strong result: As with intelligence, empirical tests typically find that political opinion is roughly one dimensional.
   D. What is the dimension? Empirically, U.S. political opinion "fits" well on the liberal-conservative or left-right spectrum.
   B. On a deep level, this spectrum may not make a great deal of sense. Libertarians, for example, often argue that there are really two dimensions - personal freedom and economic freedom:
      1. Libertarians - pro-personal, pro-economic
      2. Populists - anti-personal, anti-economic
      3. Liberals - pro-personal, anti-economic
      4. Conservatives - anti-personal, pro-economic

E. But empirically, most people line up on the diagonal, and the other two boxes are sparsely inhabited.
F. Poole and Rosenthal's long-term study of the U.S. Congress finds that a one-dimensional l-c model works very well.
G. A second dimension (related to race) occasionally pops up, but is no longer important. P&R's story: During the 50's, otherwise liberal Southern Democrats often opposed civil rights measures, and otherwise conservative Republicans often favored them. Once the Southern Democrats left the party, and debate shifted from "equality of opportunity" to "equality of result," position on further civil rights measures began to correlate well with the rest of the liberal-conservative dimension.
H. Similarly, Levitt and earlier researchers have found that one-dimensional ideological measures of l-c like ADA scores give better predictions of politicians' behavior than measures of constituent interests. Marginal predictive value of alternative scores is limited.
I. Less work has been done on the dimensionality of individual citizens' opinions, but once again, a strong liberal-conservative dimension pops out of the data.
J. Remarkably, voting in the U.N. is also one-dimensional, in spite of the extreme heterogeneity of the participants. The dimension is something like "attitudes towards the U.S./Israel."

III. Ideological Voting
F. As mentioned earlier, the main problem with the simple sociotropic voting model is that it has trouble explaining disagreement.
G. The empirical evidence on ideology suggests a more sophisticated interpretation of sociotropic voting.
H. Motivation is indeed sociotropic: People support the policies they think are in the public interest.
I. But: There are large ideological disagreements about the public interest. Ideology determines beliefs about what policies "work" and what counts as "working."
J. Ex: Affirmative action. Conservatives and liberals argue about whether it works (are blacks better-off because of it?), but also disagree about what it means to "work" (a "level playing field" versus a "fair outcome"?).
K. Important theoretical point: If ideology is one-dimensional, and people largely vote ideologically, then the simple MVT's seemingly strong assumptions are satisfied. Perhaps the issue-space only *looks* multi-dimensional.

V. Ideology and Reduction
A. Main objection to ideological voting model: Can't ideology be reduced to personal interests?
B. Ex: Isn't conservatism just the "ideology of the rich," and liberalism the "ideology of the poor"?

C. No. The correlation between income and professed ideology is very low. In the GSS, for example, the correlation between real income and POLVIEWS (a 1-7 measure of left-right ideology) is .06.
D. So what does determine ideology? Is it education?
E. Once again, no. Education and ideology are close to unrelated (r=-.03) when you look at a random sample of Americans from the GSS (as opposed to, say, a 50/50 sample of random Americans and university faculty!).
F. In a multiple regression framework, there is a tendency for income to make people more conservative and education to make people more liberal. [Table 2]
G. Both are clearly statistically significant, but the actual effect is small. On a 6-point scale:
    1. Raising log of real income by 1 – a huge change - makes people .096 units more conservative.
    2. Going from a high school degree to a BA makes people .084 units more liberal.
H. What then is ideology? As far as anyone can show, ideology is an independent causal force. Ideology explains a great deal about people's beliefs, but no standard social science variable does much to explain ideology.
I. Maybe someone will one day show that ideology reduces to something else, but given the failure of all the obvious candidates, I doubt it. (But stay tuned for the genetics of politics next week!)

VI. Case Study: The Determinants of Party Identification, II
A. Question: Returning to last week's linear probability model of party identification, what happens in the GSS if you also control for stated ideology? N≈41,000, so focus on magnitudes, not t-stats.
B. [Tables 3a&3b]
C. Answer: Ideology matters even more than race. Moreover, the slight change in the other coefficients shows that ideology is far from a "mere proxy for self-interest."
D. Consider two examples for 2010.
    1. Ex. #1: Black female with $1M annual income in 1986 dollars, 30 years old, college graduate.
    2. Ex. #2: White male with $10k annual income, 30 years old, high school education, conservative ideology.
E. Ex. #1: [Since we don't know ideology, use Tables 1a and 1b] Estimated probability of being a Democrat: 56.4%; estimated probability of being a Republican: 26.6%.
F. Ex. #2: [Using Tables 3a and 3b] Estimated probability of being a Democrat: 6.8%; estimated probability of being a Republican: 59.1%. (Age coefficient to one more decimal place=.0005).

VII. Income, Education, Ideology, and Opinion

A. For specific opinions (as opposed to party identification), income empirically often seems to make a large difference.
    1. Ex: High income people seem much more in favor of immigration than low income people.
B. **But** the effect of income almost always disappears once you control for **education**. Ph.D.s who drive cabs think like other Ph.D.s, not other cab drivers.
C. How does education affect opinion? More educated people tend to be both more tolerant and more appreciative of free markets.
D. Even though *voting* is one-dimensional, *opinion* looks two-dimensional.
E. Moreover, the two dimensions more or less fit the two-dimensional personal freedom/economic freedom diagram. Education shifts the diagonal up and to the right.
F. This fact suggests that politicians might really compete over two dimensions rather than one, again raising doubts about the median voter model.
G. In practice, however, the liberal-conservative dimension appears to be far more electorally salient. Education affects issue beliefs, but appears to be independent of party identification.
H. Why? How come liberals ally, but not high school drop-outs?

VIII. Case Study: Economic Beliefs
A. Now let us go through two illustrations from the SAEE: tendency to blame economic difficulties on:
    1. Immigration
    2. "Excessive profits"
B. If we do not control for education, income appears to have a large effect on these beliefs. [Table 4a, 4b]
C. Controlling for education, though, makes the apparent effect of income almost disappear. [Table 5a, 5b]
D. Immigration.
    1. Opposition shrinks as education rises.
    2. Opposition grows as conservatism rises.
E. "Excessive profits."
    1. Assigning blame falls as education rises.
    2. Assigning blame falls as conservatism rises.

IX. The Ideology*Education Interaction
A. Ideology and education *interact* in an interesting way. Despite their slight correlation, ideology*education has more predictive power than ideology alone.
B. Simple explanation: The higher your education level, the more likely you are to know what your ideology says about a given topic. For someone with a grade-school education, "liberal" is just a word; for a Ph.D., it is an integrated worldview.

C. This works for party identification: The tstat on ideology*education is higher than the tstat on ideology alone, rising from 44 and 61 to 48 and 67. [Tables 3a&3b vs. Tables 6a&6b]

D. It also works on individual issues. For immigration, the tstat rises from 3.9 to 4.3 [Table 4a versus 7a]; for excessive profits, from 4.6 to 4.9 [Table 4b versus 7b].

E. Returning to the two-dimensional diagram, education "stretches" the liberal-conservative spectrum.

Table 2: The Determinants of Ideology (POLVIEWS rescaled to go from -3 to +3)

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.095	.007	.067	.005	12.754	.000
EDUC	-.023	.002	-.051	.005	-9.445	.000
BLACK	-.300	.021	-.070	.005	-14.156	.000
OTHRACE	-.218	.030	-.036	.005	-7.163	.000
SEX	-.085	.013	-.031	.005	-6.401	.000
AGE	.008	.000	.102	.005	20.500	.000
YEARA	4.674	.644	.037	.005	7.253	.000
Constant	-10.045	1.281			-7.842	.000

Table 3a: Conditional Probability of Being a Democrat, with Ideology

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.002	.003	.003	.005	.636	.525
EDUC	-.006	.001	-.040	.005	-7.784	.000
BLACK	.340	.007	.224	.005	47.328	.000
OTHRACE	.120	.010	.055	.005	11.688	.000
SEX	.055	.004	.057	.005	12.217	.000
AGE	.004	.000	.120	.005	25.314	.000
YEARA	-3.525	.218	-.078	.005	-16.186	.000
POLVIEWSA	-.073	.002	-.207	.005	-44.341	.000
Constant	7.178	.433			16.582	.000

Table 3b: Conditional Probability of Being a Republican, with Ideology

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.027	.002	.059	.005	11.857	.000
EDUC	.010	.001	.066	.005	12.896	.000
BLACK	-.195	.007	-.139	.005	-29.535	.000
OTHRACE	-.124	.009	-.062	.005	-13.088	.000
SEX	.002	.004	.002	.005	.418	.676
AGE	.000	.000	.018	.005	3.709	.000
YEARA	1.225	.200	.029	.005	6.122	.000
POLVIEWSA	.093	.002	.285	.005	61.291	.000
Constant	-2.578	.398			-6.479	.000

Table 4a: Effect of Income on Beliefs About Immigration, No Education Control

Dependent Variable: IMMIG
Method: Least Squares
Date: 10/23/01 Time: 13:02
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1362 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.581155	0.176059	8.980843	0.0000
BLACK	-0.141790	0.076408	-1.855686	0.0637
ASIAN	-0.002224	0.092337	-0.024084	0.9808
OTHRACE	-0.004465	0.090074	-0.049576	0.9605
AGE	-0.009174	0.007457	-1.230223	0.2188
AGE^2	0.000139	7.59E-05	1.832582	0.0671
MALE	-0.130501	0.042039	-3.104298	0.0019
IDEOLOGY*(1-OTHIDEOL)	0.106427	0.023119	4.603419	0.0000
OTHIDEOL	0.242322	0.150883	1.606028	0.1085
JOBWORRY	0.049389	0.019877	2.484734	0.0131
YOURFAM5	-0.018488	0.033123	-0.558180	0.5768
YOURNEXT5	-0.037205	0.033983	-1.094799	0.2738
INCOME	-0.041745	0.010383	-4.020541	0.0001

R-squared	0.069468	Mean dependent var	1.218796
Adjusted R-squared	0.061191	S.D. dependent var	0.779419
S.E. of regression	0.755196	Akaike info criterion	2.285819
Sum squared resid	769.3625	Schwarz criterion	2.335612
Log likelihood	-1543.643	F-statistic	8.392399
Durbin-Watson stat	2.049180	Prob(F-statistic)	0.000000

Table 4b: Effect of Income on Beliefs About "Excessive Profits," No Education Control

Dependent Variable: PROFHIGH
Method: Least Squares
Date: 10/23/01 Time: 13:02
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1355 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.346526	0.164472	8.186947	0.0000
BLACK	0.078105	0.071559	1.091486	0.2753
ASIAN	-0.011367	0.087285	-0.130229	0.8964
OTHRACE	0.160538	0.085611	1.875199	0.0610
AGE	0.010419	0.006962	1.496472	0.1348
AGE^2	-7.23E-05	7.09E-05	-1.020087	0.3079
MALE	-0.202624	0.039320	-5.153159	0.0000
IDEOLOGY*(1-OTHIDEOL)	-0.090241	0.021657	-4.166787	0.0000
OTHIDEOL	0.180299	0.140710	1.281355	0.2003
JOBWORRY	0.037830	0.018623	2.031381	0.0424
YOURFAM5	-0.056647	0.030934	-1.831217	0.0673
YOURNEXT5	-0.104313	0.031768	-3.283568	0.0011
INCOME	-0.036220	0.009713	-3.729038	0.0002

R-squared	0.108802	Mean dependent var	1.272325
Adjusted R-squared	0.100833	S.D. dependent var	0.742522
S.E. of regression	0.704092	Akaike info criterion	2.145732
Sum squared resid	665.2902	Schwarz criterion	2.195732
Log likelihood	-1440.733	F-statistic	13.65318
Durbin-Watson stat	2.008430	Prob(F-statistic)	0.000000

Table 5a: Effect of Income on Beliefs About Immigration, Education Control

Dependent Variable: IMMIG
Method: Least Squares
Date: 10/23/01 Time: 12:49
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1362 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.883690	0.174664	10.78466	0.0000
BLACK	-0.174951	0.074420	-2.350864	0.0189
ASIAN	0.035971	0.089924	0.400013	0.6892
OTHRACE	-0.032613	0.087676	-0.371975	0.7100
AGE	-0.004571	0.007273	-0.628464	0.5298
AGE^2	8.37E-05	7.41E-05	1.129602	0.2588
MALE	-0.115403	0.040928	-2.819625	0.0049
IDEOLOGY*(1-OTHIDEOL)	0.088741	0.022578	3.930411	0.0001
OTHIDEOL	0.253523	0.146774	1.727304	0.0843
JOBWORRY	0.036076	0.019394	1.860182	0.0631
YOURFAM5	0.004961	0.032329	0.153453	0.8781
YOURNEXT5	-0.025312	0.033084	-0.765072	0.4444
INCOME	-0.011501	0.010667	-1.078253	0.2811
EDUCATION	-0.121877	0.013828	-8.814086	0.0000

R-squared	0.120175	Mean dependent var	1.218796
Adjusted R-squared	0.111690	S.D. dependent var	0.779419
S.E. of regression	0.734604	Akaike info criterion	2.231255
Sum squared resid	727.4387	Schwarz criterion	2.284878
Log likelihood	-1505.485	F-statistic	14.16323
Durbin-Watson stat	2.020208	Prob(F-statistic)	0.000000

Table 5b: Effect of Income on Beliefs About "Excessive Profits," Education Control

Dependent Variable: PROFHIGH
Method: Least Squares
Date: 10/23/01 Time: 12:49
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1355 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.509230	0.166386	9.070651	0.0000
BLACK	0.060476	0.071038	0.851317	0.3947
ASIAN	0.008011	0.086629	0.092480	0.9263
OTHRACE	0.144138	0.084945	1.696828	0.0900
AGE	0.012815	0.006920	1.851821	0.0643
AGE^2	-0.000101	7.05E-05	-1.432204	0.1523
MALE	-0.194440	0.039020	-4.983073	0.0000
IDEOLOGY*(1-OTHIDEOL)	-0.099322	0.021551	-4.608611	0.0000
OTHIDEOL	0.185962	0.139513	1.332934	0.1828
JOBWORRY	0.030960	0.018516	1.672024	0.0948
YOURFAM5	-0.044179	0.030774	-1.435562	0.1514
YOURNEXT5	-0.097896	0.031524	-3.105476	0.0019
INCOME	-0.020394	0.010153	-2.008678	0.0448
EDUCATION	-0.064849	0.013178	-4.920943	0.0000

R-squared	0.124610	Mean dependent var	1.272325
Adjusted R-squared	0.116123	S.D. dependent var	0.742522
S.E. of regression	0.698080	Akaike info criterion	2.129311
Sum squared resid	653.4895	Schwarz criterion	2.183157
Log likelihood	-1428.608	F-statistic	14.68370
Durbin-Watson stat	2.000165	Prob(F-statistic)	0.000000

Table 6a: Conditional Probability of Being a Democrat, with Ideology*Educ

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.003	.003	.005	.005	1.012	.312
EDUC	-.006	.001	-.039	.005	-7.709	.000
BLACK	.340	.007	.223	.005	47.502	.000
OTHRACE	.118	.010	.054	.005	11.485	.000
SEX	.053	.004	.055	.005	11.834	.000
AGE	.004	.000	.120	.005	25.458	.000
YEARA	-3.505	.217	-.077	.005	-16.165	.000
polviewsa * educ	-.006	.000	-.225	.005	-48.393	.000
Constant	7.131	.431			16.544	.000

Table 6b: Conditional Probability of Being a Republican, with Ideology*Educ

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.026	.002	.057	.005	11.444	.000
EDUC	.010	.001	.065	.005	12.841	.000
BLACK	-.195	.007	-.139	.005	-29.731	.000
OTHRACE	-.121	.009	-.060	.005	-12.848	.000
SEX	.004	.004	.005	.005	1.015	.311
AGE	.000	.000	.018	.005	3.738	.000
YEARA	1.202	.199	.029	.005	6.052	.000
polviewsa * educ	.007	.000	.308	.005	66.942	.000
Constant	-2.521	.395			-6.386	.000

Table 7a: Effect of Income on Beliefs About Immigration, Ideology*Educ Interaction

Dependent Variable: IMMIG
Method: Least Squares
Date: 10/23/01 Time: 12:54
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1362 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.901975	0.174285	10.91305	0.0000
BLACK	-0.167020	0.074339	-2.246730	0.0248
ASIAN	0.038885	0.089935	0.432370	0.6655
OTHRACE	-0.032774	0.087630	-0.374001	0.7085
AGE	-0.004735	0.007263	-0.651871	0.5146
AGE^2	8.50E-05	7.40E-05	1.148399	0.2510
MALE	-0.116930	0.040887	-2.859876	0.0043
IDEOLOGY*(1-OTHIDEOL)*EDUCATION	0.020108	0.004718	4.261634	0.0000
OTHIDEOL*EDUCATION	0.062666	0.032606	1.921896	0.0548
JOBWORRY	0.036512	0.019397	1.882333	0.0600
YOURFAM5	0.005987	0.032285	0.185437	0.8529
YOURNEXT5	-0.025103	0.033047	-0.759605	0.4476
INCOME	-0.011887	0.010661	-1.114952	0.2651
EDUCATION	-0.124634	0.013817	-9.020040	0.0000

R-squared	0.122481	Mean dependent var	1.218796
Adjusted R-squared	0.114018	S.D. dependent var	0.779419
S.E. of regression	0.733641	Akaike info criterion	2.228631
Sum squared resid	725.5321	Schwarz criterion	2.282253
Log likelihood	-1503.698	F-statistic	14.47294
Durbin-Watson stat	2.021390	Prob(F-statistic)	0.000000

Table 7b: Effect of Income on Beliefs About "Excessive Profits," Ideology*Educ Interaction

Dependent Variable: PROFHIGH
Method: Least Squares
Date: 10/23/01 Time: 12:54
Sample(adjusted): 1 1510 IF ECON<1
Included observations: 1355 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.504577	0.166017	9.062768	0.0000
BLACK	0.048497	0.070958	0.683463	0.4944
ASIAN	-0.004565	0.086640	-0.052685	0.9580
OTHRACE	0.135789	0.084901	1.599375	0.1100
AGE	0.013030	0.006910	1.885486	0.0596
AGE^2	-0.000104	7.04E-05	-1.471935	0.1413
MALE	-0.192414	0.038981	-4.936041	0.0000
IDEOLOGY*(1-OTHIDEOL)*EDUCATION	-0.022115	0.004490	-4.924966	0.0000
OTHIDEOL*EDUCATION	0.049965	0.030994	1.612075	0.1072
JOBWORRY	0.028983	0.018517	1.565193	0.1178
YOURFAM5	-0.046264	0.030730	-1.505501	0.1324
YOURNEXT5	-0.096444	0.031489	-3.062790	0.0022
INCOME	-0.019645	0.010146	-1.936233	0.0530
EDUCATION	-0.065029	0.013171	-4.937448	0.0000

R-squared	0.126969	Mean dependent var	1.272325
Adjusted R-squared	0.118506	S.D. dependent var	0.742522
S.E. of regression	0.697138	Akaike info criterion	2.126612
Sum squared resid	651.7280	Schwarz criterion	2.180458
Log likelihood	-1426.780	F-statistic	15.00220
Durbin-Watson stat	2.001392	Prob(F-statistic)	0.000000

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 6: Voter Motivation, III: Miscellaneous

I. Religion, Party, and Ideology
   A. Many observers of modern American politics think that the divide between secular and religious voters matters. Does it?
   B. The General Social Survey has measures of religious belief (especially Biblical literalism) and religious practice (especially church attendance). N≈26,000. Bible goes from 1-4, 1 being most literalist; ATTEND goes from 1-7, 7 being most frequent.
   C. First, let's add these measures to the initial linear probability models from Week 4. (Tables 8a&8b)
   D. Results: Both measures have substantial but not overwhelming predictive power, especially for Republicans.
   E. What about religion and ideology? Table 9 shows that our two religious measures are by far the strongest predictors of ideology. If the liberal-conservative divide is "really" something else, it's a secular-religious divide.
   F. Note, however, that the magnitudes are still not huge. The ideology variable goes from -3 to +3, but moving from the minimum to the maximum on the religious variables only makes you 1.32 units more conservative.
   G. What if we race ideology against religion as a determinant of party identification? Ideology still crushes religion, especially for P(Dem). (Tables 10a and 10b)

II. Personality and Ideology
   A. The Five Factor Model now reigns supreme in personality psychology. Acronym: OCEAN. (Myers-Briggs analogs in parenthesis).
      1. Openness to Experience (Intuitive vs. Sensing)
      2. Conscientiousness (Judging vs. Perceiving)
      3. Extraversion (Extraverted vs. Introverted)
      4. Agreeableness (Feeling vs. Thinking)
      5. Neuroticism (No MB analog, but the negative of Neuroticism is Stability)
   B. Despite economists' incredulity, personality measures are predictively useful. Ex: Occupational choice.
   C. Especially given the low MC of voting one way or another, it seems plausible that personality would have large effects on political views. Do they?
   D. Data sets with personality and political info are scarce, but some serious results are now in. Gerber et al summarize past findings, and present some new ones.

E. Robust past findings: Conservatives are lower in Openness and higher in Conscientiousness. Lower Openness and Higher Conscientiousness predict higher conservatism for almost all measures; higher Stability predicts higher conservatism for most but not all measures. (Table 4)
F. Magnitudes in Gerber et al's data: Personality variables go from 0-1, ideology goes from 1-5. So going from the minimum to the maximum level of Openness makes people about a point less conservative, and going from the minimum to the maximum level of Conscientiousness makes people about half a point more conservative.
G. Gerber et al distinguish economic and social ideology (scaled to have mean=0 and SD=1) and find additional patterns, even controlling for education and church attendance. (Table 6 and Figure 1)
H. The robust predictors of social conservatism, like overall conservatism, are Openness (-), and Conscientiousness (+).
I. The robust predictors of economic conservatism are: Extraversion (+), Agreeableness (-), Conscientiousness (+), Stability (+), and Openness (-). Free-marketeers are closed, conscientious, disagreeable, emotionally stable extraverts.
J. Interpretation? Two they consider, and one they don't:
    1. Some personalities are less self-interested than others.
    2. Some personalities have *different* interests than others.
    3. Some personalities see the world more clearly than others.
K. Compared to other predictors of ideology, these are strong. But in absolute terms, ideology remains hard to predict.

III. Genes and Political Behavior
A. Political attitudes and behavior often seem to run in families. Why is this?
B. People usually assume it's nurture, but in most families, there is a confounding variable: genes.
C. How can we distinguish the effects of nature and nurture? There are two standard "behavioral genetic" approaches:
    1. Twin studies
    2. Adoption studies
D. Adoption studies are still fairly unexplored for political attitudes and behavior, but quite a few twin studies exist.
E. Main findings: Nurture matters a lot for party identification.
F. However, genes account for most or all of the family resemblance in:
    1. Whether you vote
    2. Whether you always vote for one party
    3. Issue positions (and a wide range have been studied!)
    4. Left-right ideology

G. There are strong parallels between the behavior genetic results for religion and politics. Religious *affiliation* is strongly influenced by parents, but by mid-adulthood, genes explain most or all familiar resemblance in:
   1. Church attendance
   2. Religious intensity (how religious you feel, how interested you are)
   3. Doctrinal views

IV. Mainstream and Polarization Effects
   A. There are interesting empirical connections between political awareness and opinion. Political scientists call these the "mainstream" and "polarization" effects. (Zaller 1992)
   B. The "mainstream" effect: When elite opinion is united, agreement with elite opinion is an increasing function of political awareness.
   C. Interpretation: For non-partisan issues, the more aware you are, the more likely you are to know what everyone is "supposed to believe."
   D. The "polarization" effect: When elite opinion is divided along ideological lines, agreement with "your" ideological leaders is an increasing function of political awareness.
   E. Interpretation: For partisan issues, the more aware you are, the more likely you are to know what people on your side of the fence are "supposed to believe."
      1. Ex: Nixon on price controls.
   F. Contrast: The Vietnam War in 1964 versus 1970.
   G. Limits of the mainstream effect: at least under censorship, susceptibility to propaganda peaks at around the 67th percentile of awareness, then declines. It takes some sophistication even to be brain-washed!
   H. Note: We could also think of the mainstream and polarization effects as “leadership” effects.

XI. Does Policy Match Public Opinion? What Are the Unpopular Policies?
   A. Now that we have a better grip on voter motivation, let us return to the earlier question: Is the median voter model correct?
   B. It is hard to do formal empirical tests on the federal government (without internationally comparable data, N=1). But there is a lot of informal evidence that the median voter gets what he wants.
   C. What does the federal government do? Is this what the median voter wants?
      1. Spending (2015)

Source	**Share**
Social Security	23.9%
Defense	15.8%
Domestic Discretionary	15.8%
Medicare	17.2%
Net Interest	6.1%

Income Security	8.2%
Medicaid	9.5%
Other Retirement/Disability	4.4%
Other	6.1%
Offsetting receipts	-7.0%

2. Taxes (2015)

Source	**Share**
Individual Income Taxes	47.4%
Payroll Taxes	32.8%
Corporate Income Taxes	10.6%
Excise Taxes/Customs	4.1%
Other	5.1%

3. A lot of regulation: Environmental, worker safety, drug safety, anti-competitive behavior, labor...

D. Starting with the budget: Social Security and Medicare remain extremely popular programs; the military is also usually well-regarded. The remaining items are more contentious.

E. Broadly defining "welfare" as Medicaid and Income Security, we get 17.7% of the budget. But:
   1. Few people want to actually abolish these programs
   2. Medicaid also pays for middle-class nursing home residents who have depleted their personal savings.

F. The national debt is unpopular, but repudiating it would be even less popular. So "net interest" ultimately has voter support.

G. That leaves 22% of the budget for "domestic discretionary" and "other" spending. Some of this spending is "waste." Waste is unpopular. But outside of isolated examples of $500 toilet seats, what spending do a majority of Americans agree is wasteful?

H. Turning to spending: It is surprising that income and SS taxes are such a large percentage of the budget. But insofar as business "passes on" corporate and other taxes, do a majority of Americans really want significant changes here?

I. Regulation is more complicated. Are there majorities in favor of weaker (or stronger) environmental regulation? Worker safety? Drugs?

J. Challenge: What policies exist that a majority of American voters oppose? Consider all the clichés of politics. Do any hold water?
   1. Relatively weak gun control?
   2. Foreign aid?
   3. NAFTA?

XII. Application: State-Level Policy

A. There have been a number of empirical studies of state-level policy.

B. Main findings: Variations in degree of liberalism are strong predictors of variation in state policy. When public opinion is liberal

(as in NY), policy is liberal; when public opinion is conservative (as in Colorado), so is policy.

C. It is hard to convincingly show that public opinion and policy match each other 1:1, but the evidence is suggestive.

XIII. Bartels' Case that Government Is Too Small

A. In the GSS, the *median* voter wants to spend more in most areas. The only area where the median voter consistently favors cuts is foreign aid.

B. Larry Bartels generalizes this finding to all 23 of the countries he looked at: "Citizens in every country in every year wanted additional government spending on health, education, old age pensions, the environment, and law enforcement."

C. Both the GSS and Bartels' data also show, however, that voters around the world want less spending *overall*! "The distribution of responses to this question is, if anything, even more skewed than for the questions in the battery on spending for specific government programs. Averaging across countries and years, about two-thirds of the respondents said they favored cuts in government spending, many 'strongly'; only 10% were opposed."

D. It is well-known that adding a warning about the connection between higher spending and higher taxes depresses support for spending.

E. GSS spending preference data doesn't have such a warning. Bartels' data does, but it's weird: "Remember that if you say "much more," it might require a tax increase to pay for it." Problems:

1. It suggests that moderate spending increases *don't* require higher taxes.
2. It fails to mention that spending cuts would *reduce* taxes.

F. When the GSS gives a binary choice between higher spending on "social programs like health care, social security, and unemployment benefits" or lower taxes, 60% want higher spending. But adding a status quo category would almost certainly show that the median person favors the status quo over change in either direction.

G. Overall: Since voters' stated budgetary preferences are contradictory, it is hard to tell if they are "getting what they want." But the contradictions are weaker for better questions, which generally show that the median voter favors the status quo.

Table 8a: Conditional Probability of Being a Democrat, with Literalism and Attendance

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	-.005	.003	-.010	.007	-1.487	.138
EDUC	.000	.001	.002	.007	.252	.801
BLACK	.378	.010	.259	.007	39.670	.000
OTHRACE	.142	.012	.076	.006	11.801	.000
SEX	.074	.006	.077	.006	12.100	.000
AGE	.003	.000	.111	.007	17.018	.000
YEARA	-3.065	.389	-.051	.006	-7.878	.000
ATTEND	-.006	.001	-.035	.007	-5.096	.000
BIBLE	.007	.005	.011	.007	1.496	.135
Constant	6.212	.776			8.008	.000

Table 8b: Conditional Probability of Being a Republican, with Literalism and Attendance

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.039	.003	.089	.007	12.817	.000
EDUC	.009	.001	.057	.007	7.922	.000
BLACK	-.272	.009	-.197	.007	-30.139	.000
OTHRACE	-.172	.011	-.098	.006	-15.090	.000
SEX	-.043	.006	-.048	.006	-7.511	.000
AGE	.000	.000	-.002	.007	-.266	.791
YEARA	-.407	.369	-.007	.006	-1.103	.270
ATTEND	.020	.001	.120	.007	17.328	.000
BIBLE	-.056	.004	-.089	.007	-12.597	.000
Constant	.730	.735			.992	.321

Table 9: Determinants of Ideology, with Literalism and Attendance

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.094	.010	.068	.007	9.781	.000
EDUC	-.019	.003	-.041	.007	-5.619	.000
BLACK	-.408	.028	-.095	.007	-14.368	.000
OTHRACE	-.252	.036	-.046	.007	-7.004	.000
SEX	-.207	.018	-.074	.006	-11.469	.000
AGE	.005	.001	.054	.007	8.147	.000
YEARA	4.492	1.151	.025	.007	3.903	.000
ATTEND	.083	.004	.161	.007	22.797	.000
BIBLE	-.292	.014	-.151	.007	-21.016	.000
Constant	-9.117	2.295			-3.973	.000

Table 10a: Conditional Probability of Being a Democrat, with Ideology and Religion

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.002	.003	.005	.007	.742	.458
EDUC	-.002	.001	-.010	.007	-1.485	.138
BLACK	.349	.009	.237	.006	36.839	.000
OTHRACE	.128	.012	.068	.006	10.730	.000
SEX	.057	.006	.060	.006	9.549	.000
AGE	.004	.000	.122	.006	19.098	.000
YEARA	-2.634	.382	-.044	.006	-6.899	.000
ATTEND	.001	.001	.004	.007	.633	.527
BIBLE	-.017	.005	-.025	.007	-3.538	.000
POLVIEWSA	-.088	.002	-.255	.006	-39.495	.000
Constant	5.353	.761			7.030	.000

Table 10b: Conditional Probability of Being a Republican, with Ideology and Religion

Regression Coefficients					Test That Each Coefficient = 0	
	B	SE(B)	Beta	SE(Beta)	T-statistic	Probability
LREALINC	.030	.003	.067	.007	9.951	.000
EDUC	.010	.001	.064	.007	9.359	.000
BLACK	-.238	.009	-.170	.006	-26.770	.000
OTHRACE	-.148	.011	-.082	.006	-13.121	.000
SEX	-.023	.006	-.025	.006	-4.065	.000
AGE	-.001	.000	-.019	.006	-3.044	.002
YEARA	-.755	.359	-.013	.006	-2.100	.036
ATTEND	.012	.001	.074	.007	10.810	.000
BIBLE	-.029	.004	-.045	.007	-6.551	.000
POLVIEWSA	.097	.002	.298	.006	46.703	.000
Constant	1.453	.716			2.028	.043

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 8: Wittman and Democratic Failure

I. Critiques of the Economic Approach
   A. Critics of the economic approach to politics dislike its "economistic" **assumptions**. Public choice allegedly ignores the most important features of political life:
      1. Morality
      2. Community
      3. Public-spirited politicians
      4. Sincere public debate
      5. Efforts to "raise awareness"
   B. Critics also dislike the **conclusions**. Public choice economists always seem to be pointing out the failures of democracy, which in the traditional view is virtually a sacred institution.
   C. The thrust of the traditional response: "Sure, given your economistic assumptions, all of your pessimistic conclusions about democracy follow. But those economistic assumptions are wrong, and democracy is working just fine. And if it's not working fine, the solution is more democracy."
   D. In other words, the critics grant that the public choice story is internally consistent, but reject its "economistic" starting point, and thereby avoid the conclusion that democracy doesn't work well.
   E. My overall judgment: While economists definitely have important things to learn from other disciplines (e.g. the failure of the SIVH), the sound criticisms are pretty easy to incorporate into the economic approach.

II. Wittman's Challenge to Orthodox Public Choice
   A. Donald Wittman of UC Santa Cruz offers a radically different critique of public choice economics.
   B. Wittman does **not** object to public choice's "economistic" approach.
   C. Instead, Wittman complaint is that so much of public choice is simply bad economics.
   D. He claims that standard public choice arguments generally depend upon extremely dubious assumptions. These can be boiled down to:
      1. "Extreme voter stupidity"
      2. "Serious lack of competition"
      3. "Excessively high negotiation/transfer costs"
   E. Wittman's contrasting conclusion: The standard tools of microeconomic analysis show that political markets work just as well as economic markets.

F. As a corollary, Wittman argues that the political failures emphasized in public choice theory are largely imaginary.

G. Related point: Yes, people in the public sector are self-interested. So what? Yes, they have acquired more power this century, but again, so what? When self-interested actors in markets increase their market share, few economists get alarmed. How does that differ from self-interested bureaucrats expanding their power?

III. How to Think Like Wittman, I: Voter Ignorance Is Not a Serious Problem

A. Many public choice arguments, according to Wittman, assume "extreme voter stupidity."

B. Normally, of course, public choice economists talk about "ignorance" or "lack of information," rather than "*stupidity*." But Wittman argues that the assumption of voter stupidity is implicit.

B. Wittman's Principle #1: *Voter ignorance is not a serious problem*.

C. Why? **First**, the *amount of information held by voters has been underestimated*.

1. Party labels are "brand names" that drastically reduce information costs.
2. Politicians pay to inform voters by advertising, giving speeches, and so on; voters don't have to pay to inform themselves.
    a) Ex: One politician takes "dirty money." The other side has a strong incentive to let the public know.
3. There are many private side benefits of acquiring political knowledge.
    a) Ex: Investors need to know what government policy will do in order to pick stocks. When they go to vote, they can easily rely on information they acquired for quite different reasons.
4. Voters may just be storing their information in an "inarticulate format." People often just take information as it arrives, adjust their conclusion, and then forget the information, *but remember the conclusion*. Thus, written tests of political knowledge don't prove much.

D. **Second**, *informed judgments can be made with little information*.

1. Voters have many "cognitive shortcuts." Voters can simply ask their preferred experts for information. Application: Just as I don't need to know anything about heart surgery to get a first-rate bypass operation, I don't need to know anything about current gun control proposals to vote intelligently about gun control. If I like guns, I just vote the NRA line; if I don't like guns, I follow the advice of Citizens for Gun Control.
2. Voters only need to know which of two candidates is *closer* to their bliss point; they don't need to know candidates' exact locations.

3. Analogy between stock markets and elections. Stock markets reflect information well even though most investors are highly ignorant.

E. **Third**, *the deleterious effect of biased information has been overstated.*
   1. Remember the Principle of Aggregation? Even if people are highly ignorant, their random errors will cancel out. Ignorance does not mean *systematic* bias.
   2. "To be uninformed about a policy does not imply that voters have biased estimates of its effects. For example, to be uninformed about the nature of pork-barrel projects in other congressional districts does not mean that voters tend to underestimate the effects of pork barrel - it is quite possible that the uninformed exaggerate both the extent and the negative consequences of pork-barrel projects."
   3. Voters can discount, or simply ignore, information from biased or questionable sources. If the media has a "liberal bias," then voters can easily adjust. ("Sure, Koppel said we need more money for the EPA, but what do you expect, he's a big liberal?")
   4. Worst case: If you "can't trust" the available sources, don't!

F. **Fourth**, *the effect of unresolved asymmetric information in politics is to make government inefficiently small, not inefficiently large.*
   1. Just as it is naive to think that asymmetric information helps used car dealers sell cars, it is naive to think that asymmetric information helps politicians create Big Government.

G. Public choice economists' focus on "rational ignorance," is, therefore, rather silly. Consumers and investors are also rationally ignorant about a great deal, but they know *enough* for markets to work well. Similarly, voters know *enough* for democracy to work well.

H. Moreover, the Principal of Aggregation assures good outcomes even in the worst case scenario. (Wittman even adds that democracy handles severe ignorance *better* than markets because aggregation protects the most clueless).

I. To reach their standard conclusions about political failure, then, ignorance is not enough. They need to assume that voters are "stupid" or **irrational**, something most economists are unwilling to do.

IV. How to Think Like Wittman, II: "Serious Lack of Competition"

A. Many other public choice arguments assume, in Wittman's phrase, a "serious lack of competition."

B. While public choice economists spend a great deal of energy studying political competition, they frequently see strong monopolistic elements as well (leading to support for things like term limits).

C. Wittman's Principle #2: *Politics, like the market, is competitive*.

D. Why? **First**, *reputation matters.*

1. If politicians break promises, voters hold it against them. If they do a good job, they reward them. Even if politicians only stay in one office for a few years, they want to build up a good name in order to rise to higher offices.
2. Even when politicians plan on leaving politics entirely, their party rewards them for protecting the party's image.
3. Parties accordingly "vet" would-be candidates for sincere ideological commitment.
4. Remember the theory of optimal punishment: Voters can adjust for a small probability of detection with harsh punishment. Politicians can destroy their whole reputation with one mistake.

E. **Second**, *political races are at least as competitive as markets.*

1. Politics is full of "political entrepreneurs" who want to stage a successful "takeover" (gain power) by locating unpopular policies and campaigning to change them.
2. Incumbent politicians know this, so they strive to *preemptively* adjust policy to please the electorate.
3. High rates of reelection prove NOTHING. "The main reason for high rates of incumbent success is... They are the best. That is why they won in the first place and why they are likely to win again."
4. Similarity of platforms also proves NOTHING. Similar prices are actually a sign of competition in markets; so are similar platforms in politics.
5. Alleged "barriers to entry" are usually minimal. Campaign contributions are just another sign of a serious candidate. If contributions were basically bribes to induce politicians to act against voter interests, political advertising would be counter-productive! Voters would vote against candidates *because* they had so much money behind them.
6. Similarly, third parties can't win because voters don't like them, not because "the system" is against them.
7. Ex: The case of Perot shows that it is easy for a third-party candidate with serious mass support to enter at the highest level.
8. "Negative" advertising is much more common in elections than markets. Doesn't this suggest that elections are actually more competitive? And there is a simple reason, too: Elections, unlike markets, are zero-sum games.
9. Don't forget Tiebout-type competition.

F. **Third**, *empirical evidence shows a strong link between voter preferences and legislative behavior.*

G. Wittman's bottom line: In markets, economists are usually skeptical about collusion. Why are they less skeptical in politics? How is the grand electoral conspiracy maintained?

V. How to Think Like Wittman, III: "Excessively High Negotiation/Transfer Costs"
   A. Finally, public choice economists often argue that transactions costs prevent more efficient policies from replacing the status quo.
      1. Ex: A special interest "blocks" changes harmful to its interests, and it is "too hard" to buy them off.
   B. This brings us to Wittman's Principle #3: *Political bargaining can eliminate any remaining significant inefficiencies.*
   C. Why? *Democracy is <u>designed</u> to have low transactions costs.*
      1. Majority rule is cheaper than the unanimity required by markets.
      2. Representative democracy (as opposed to direct democracy) drastically reduces transactions costs. Instead of 300 M Americans bargaining, we have a few hundred Congressmen and Senators bargaining. (The same logic holds for committees).
      3. Log-rolling can turn efficient but unpopular policies into efficient AND popular policies.
      4. Long-term political contracts are rarely legally enforceable. But reputation - of both parties and individual politicians - accomplishes the same thing.
      5. Interest groups also reduce transactions costs by giving legislators information.

VI. Wittman's Sampler, I: Pork Barrel Politics
   A. Pork barrel politics allegedly stem from the geographic nature of representative. Every Congressman wants to "bring home the pork" to his district.
   B. Reply #1: Presidents, governments, and other non-geographically-based politicians often favor larger expenditures than legislatures.
   C. Reply #2: Many programs can be simultaneously abolished with an Omnibus Repeal Bill (like the base closings bill).
   D. Reply #3: Political parties can take credit for "universal" policies.
   E. Public choice economists sometimes say that political bargaining fails because voters won't accept "blatant transfers." (Think of the NJ Turnpike workers).
   F. Reply #4: Wittman calls this *knife-edge stupidity*. How come voters can recognize efficient transfers but not inefficient transfers?

VII. Wittman's Sampler, II: Concentrated Versus Diffuse Interests
   A. Ever since Olson, public choice economists have been impressed by the ability of interest groups to solve their internal collective action problem in order to take advantage of the disorganized majority. Standard examples:
      1. Tariffs

2. Subsidies
3. Teachers' unions
4. NRA

B. Reply #1: Mathematical improbability: Even if politicians lose only a small fraction of majority's votes, it will rarely be balanced by large fraction of interest group member's votes.

C. Reply #2: Interest groups compete with each other, directly or indirectly.

D. Reply #3: Competing politicians can advertise their opponents' reliance on special interest money. ("He took $10 M from the tobacco lobby.")

E. Reply #4: Politicians realize interest groups are biased, and discount their advice accordingly.

F. Reply #5: Special interests win in referenda, too. Ex: Gun control.

G. Reply #6: Total level of donations is very small, suggesting that politicians aren't selling much of value.

VIII. Wittman's Sampler, III: Bureaucracy

A. Public choice economists have spent a lot of energy arguing that the popular suspicions about "bureaucracy" are justified. Bureaucracies supposedly exploit their monopoly power and voter ignorance to "build empires."

B. Two variants:
1. Bureaucracies are inefficient, slow, and directionless. Related complaint: "satisficing"
2. Bureaucracies are sophisticated promoters of the interests of bureaucrats. Related idea: "budget maximization."

C. Reply #1: Incremental change is perfectly consistent with maximization (as opposed to satisficing).

D. Reply #2: Bureaus compete for funds, so even if they are all budget-maximizers, it may not matter much.

E. Reply #3: "Managers" compete to run bureaus, so alleged monopoly power is really quite limited.

F. Reply #4: Even if politicians can do what they want because of rational ignorance, why would politicians charitably "share" this slack with bureaucrats?

G. Reply #5: If bureaus really have monopoly power, they will exert it to get extra pay, not bigger budgets. (Knife-edge stupidity, again).

H. Reply #6: Monopoly models predict output is too small, not too large!

I. Reply #7: If Congress always does what bureaus suggest, this is NOT evidence of bureaucratic power. Maybe the bureaus only suggest what they know Congress wants to hear.

J. Reply #8: Optimal punishment, again. How is the discretion of bureaucrats any worse than the discretion of lawyers, managers, etc.?

K. Reply #9: Asymmetric information, again.

IX. Validity Versus Soundness

A. Wittman points out that there are four logically possible positions to take on the efficiency of markets and democracy:
   1. Position #1: Markets fail, democracy works. (View typical of social democrats).
   2. Position #2: Markets work, democracy fails. (View typical of public choice economists).
   3. Position #3: Markets fail, democracy fails. (View typical of hard-line Marxists).
   4. Position #4: Markets work, democracy works. (Wittman's view).

B. Wittman's goal: End economists' "schizophrenia."

C. Many public choice economists think that Wittman's *arguments* are poor.

D. But we must keep a basic logical distinction between validity and soundness firmly in mind.
   1. An argument is *valid* if it logically follows from its assumptions.
   2. An argument is *sound* if it logically follows from its assumptions AND those assumptions are true.

E. On the whole, I think Wittman's arguments are usually *valid*. He is definitely on to something when he points out other economists' "schizophrenia."

F. However, I strongly doubt that many of Wittman's arguments are *sound*. He reasons carefully from his assumptions, but rarely considers the possibility that some of these assumptions are deeply wrong.

G. If Wittman's assumptions are wrong but widely-held, successful critiques of Wittman will probably have wide-ranging ramifications for public choice (as we will see in the next three weeks).

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 9: Expressive Voting

I. The Instrumental Voting Assumption
   A. One key assumption we made before the midterm is that voters vote *instrumentally*.
   B. In other words, votes care about nothing except the policies they get. They aren't interested in personalities, entertainment, impressing their friends with their social conscience, etc.
      1. Slightly different perspective: Is voting *investment* or *consumption*? Do people vote in order to get a later pay-off, or is voting "its own reward"?
   C. Purely instrumental voting seems unrealistic. Image, symbols, faces, and so on matter at least as much to voters as policy.
   D. There are many "Mom and apple pie" issues where all candidates agree; they just try to wax more poetic than their competitors.

II. Instrumental Versus Expressive Value
   A. Economists usually focus on the *instrumental* value of products - what the products do.
   B. But empirically, it is hard to ignore the fact that consumers also care about the *expressive* value of products - what they "say about a person," the product's "image," etc.
      1. Is expressive value a means to the end of *signaling* desirable characteristics to other people? Or is expression an end in itself? For purposes of this week's analysis, it makes little difference, but it is an interesting question.
   C. Examples to make the difference clear:
      1. Cheering at a football game. Are fans cheering in order to help their team win? Or are they primarily *expressing* their "team spirit"?
      2. Getting a get-well card for a sick friend. Are you trying to cure them, or simply *express* sympathy?
      3. Buying perfume. Do you buy it just for the smell? Or are you also buying an "image" created by Calvin Klein's ads?
      4. Joining the Million Mom March. Are you going solely to change gun policy? Or are you also "showing that you care," to *express* your concern for the nation's children?
   D. Most products provide a *mix* of both instrumental and expressive value.
   E. But the mix varies. When I buy a pick ax, I'm not doing it to "partake in the legend of Paul Bunyan." But most people think about "image" when they buy a car, or pick their clothes, or make many other kinds of purchases.

F. What can we learn if we extend this insight - that products provide a mix of instrumental and expressive value - to voting?

G. Geoffrey Brennan and Loren Lomasky address this question in *Democracy and Decision* - in my judgment, one of the five best books in public choice ever written. The following discussion relies heavily on their work.

III. Decisiveness Revisited

A. If part of the motive for voting is expressive, there is a shocking implication: People do NOT necessarily vote for the *policies* that they most prefer.

B. Why? Because expressive and instrumental motives could work in different directions. A person might, on instrumental grounds, prefer peace to war; but the expressive value of patriotism might outweigh this.

1. Similarly, if part of the motive for buying a car is expressive, people will not necessarily buy the car with the mechanical properties they most prefer.

C. How exactly can one weigh instrumental and expressive values against each other in an election? The critical variable to remember: the *probability of decisiveness*.

D. Crucial insight: your vote may not (indeed, almost certainly will not) change the electoral outcome. But you get the expressive value either way!

1. Ex: Even if your candidate loses, you can still feel smugly superior in your devotion to the homeless.

E. What then is the total value of a policy to a voter? It is the probability of decisiveness *times* the instrumental value, *plus* the expressive value.

F. Let us define one voter's I_A as the instrumental value of policy A, E_A as the expressive value of policy A, and p as the probability of decisiveness.

G. Then when the voter chooses between policy A and policy B, he strictly prefers A to B if: $pI_A + E_A > pI_B + E_B$.

H. Now recall that for most realistic elections, $p \approx 0$. Then the voter will choose policy A over policy B so long as: $E_A > E_B$. In other words, in a typical election, *expressive value is ALL that matters!*

IV. Decisiveness and the Relative Prices of Instrumental and Expressive Voting

A. In markets, the logic of decisiveness reverses. The typical consumer choice in markets is almost *completely* decisive. When you order chicken at a restaurant, you are virtually sure to get chicken: $p \approx 1$.

B. Thus, when a diner chooses between meal A and meal B, he strictly prefers A to B if: $I_A + E_A > I_B + E_B$. In others words, in a

typical market transaction, *instrumental and expressive value count EQUALLY.*

C. Slightly different perspective: In markets, participants will be willing to give up $1 of expressive value in order to get $1 in instrumental value.

D. In politics, however, participants will be willing to give up $1 of expressive value only if they receive $1/p in instrumental value in return.

1. Ex: If p were 1-in-a-million, they would only give up $1 in expressive value for $1,000,000 in instrumental value!

E. Thus, the relative prices of instrumental and expressive value differ *systematically* between markets and politics. *Expressive value is dramatically cheaper in politics than in markets.*

F. This does not mean that we should expect no role for expressive value in markets. But it does mean that we should expect **vastly more** in politics.

G. Ex: When you buy a car, you might consider the personality of salesman. But are you willing to pay $1000 extra to buy your car from the "nice guy"? In contrast, suppose that one politician's policies are $1000 better for you than his rival's, but the rival has a great smile. If p=1-in-a-100,000, you will vote for the rival so long as that great smile is worth a penny to you.

V. The Hanson/Cowen Critique

A. My colleagues Robin Hanson and Tyler Cowen do not buy the preceding argument.

B. Basic objection: Why isn't expressive value adjusted for probabilities, too?

1. Ex: You do not feel like a great person when you donate a penny to charity. Why would you feel like a great person when you *vote* against your financial interests? The former is probably a bigger sacrifice than the latter.

C. Variant: Perhaps expressive value *depends* on decisiveness. You feel better when you personally "made a difference."

D. My reply: Appeal to introspection. B&L's is a more plausible description of how people really think.

1. Query: What does your introspection say?

VI. Expressive Voting as Political Pollution

A. At this point, one might say "So what if democracy counts expressive value more?" Human welfare (and efficiency) encompasses BOTH expressive and instrumental values.

B. This is a good question, but it has a good answer: *In democracy, instrumental values are a public good!*

C. Individual voters personally enjoy all of the expressive value of their vote, but get no personal benefit from voting for policies with high instrumental value.

D. Thus, there is a *voter-on-voter* externality of expressive voting.

E. Similarly, individual polluters personally enjoy all of the benefits of polluting (driving a cheap gas-guzzling car), but get no personal benefit from cutting back their emissions.
F. In both cases, there is an inefficient outcome! Polluters ignore the social benefits of clean air; voters ignore the social benefits of instrumentally valuable policies.
G. In both cases, "preaching" is unlikely to change behavior. People are optimally responding to the incentives they face.
H. At first, the idea that the instrumental and expressive value of policies can diverge is puzzling. But it is quite intuitive.
    1. Is the "most likeable" politician always the one who favors the most sensible policies?
    2. Is the "morally required" policy always the most effective? Ex: The minimum wage is very popular, even though it is at best a dubious way to help the poor.
I. Question: How do politicians respond to expressive voting?
J. Answer: Due to electoral competition, they have to give voters what they want. So instead of focusing on "boring" substantive issues, they emphasize personality, catchy slogans, poetic language, flag-burning, gay marriage, etc.

VII. Inefficient Unanimity
A. Surely any policy that EVERYONE votes in favor of must be efficient? Brennan and Lomasky prove, surprisingly, that the answer is NO.
B. Suppose voters get to decide whether to declare war on a hated national enemy.
C. Each voter who votes Yes feels like a brave patriot, getting $100 in expressive value.
D. But if war is actually declared, the country will be thrown into a bloody conflict that costs each voter an average of $100,000.
E. So what does each voter decide? Each person votes Yes so long as $p^* - \$100{,}000 + \$100 > 0$.
F. As long as $p < .001$, then, they vote Yes.
G. Since everyone is identical by assumption, it follows that as long as $p < .001$, 100% of all voters vote for war.
H. But what is the net per-capita social benefit of war? -$99,900!
I. How is this possible? There are massive externalities of expressive voting.
J. Just as all polluters can be better off if everyone polluted less, all voters can be better off if everyone voted differently – or if someone overturns the electoral result.

VIII. Application: Environmentalism
A. "Caring about the environment" is probably one of the biggest expressive issues of our time.
B. There are of course some instrumental values involved too: Few people want to breath the air of Mexico City.

C. But most environmental issues look largely expressive:
    1. Recycling
    2. Preserving wild lands
    3. Endangered species
    4. Conservation
    5. Logging
D. Moreover, even for the more instrumental-looking problems, voters are usually bizarrely hostile to "the easy way out":
    1. Emissions trading, domestic and international
    2. Planting trees as carbon sinks
    3. Liming lakes to counter acid rain
    4. Privatizing common resources
    5. Geoengineering
E. An overwhelming majority of Americans prefer to hang out at malls than camp out in the wilderness for fun. But what politician would dare to advocate privatizing the national parks so Americans have more money to spend at the mall?
F. Simple explanation: Voter-on-voter externalities lead democracy to deliver a highly inefficient outcome.

IX. Answering Wittman, I
A. To my mind, expressive voting theory is the first pillar of a thoughtful reply to Wittman. It shows that to a large degree, voters aren't even *trying* to "make democracy work."
B. Rather, democracy's lack of incentives induces them to focus lop-sidedly on symbols, entertainment, personalities, and so on.
C. Key asymmetry between politics and markets: The low probability of being decisive leads to *systematic* under-valuation of instrumental concerns.
D. Expressive voting theory helps us understand why the drama of politics dominates over substance. Politicians are just competitively playing to their audience.
E. Other supply-side implications?
F. Can expressive voting theory breathe new life into old political failures?
    1. Pork barrel politics
    2. Concentrated interests
    3. Bureaucracy
    4. Political advertising and special interests

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854
I.

Week 10: Ignorance, Irrationality, and Aggregation: Theory and Evidence

I. Return to the "Miracle of Aggregation"
   A. The leading explanation for democratic failure is voters' rational ignorance.
   B. There can be little doubt that voters *are* highly ignorant.
   C. But as discussed earlier, many assert that voter ignorance is quite compatible with well-functioning democracy!
   D. Why? If we interpret "ignorance" as "random error," then the Principle of Aggregation kicks in. If you tabulate millions of random errors and take an average, the aggregate acts "as if" it were fully informed. That is the Miracle of Aggregation.
   E. So far, so good. But why should we believe that voters' errors ARE random in the first place?

IV. Ignorance, Irrationality, and Systematic Error
   A. There are two distinct ways economists apply the concept of "rationality":
      1. Rationality of action
      2. Rationality of belief
   B. In the last thirty years, rational expectations has been a standard technique for modeling economic actors' beliefs. Economists often refer to "rationality" and "rational expectations" interchangeably.
   C. Key feature of RE: calibration. RE requires some connection, albeit imperfect, between agents' beliefs and the real world.
   D. RE partitions error between:
      1. Irrationality - the systematic component
      2. Ignorance - the random component
   E. RE then rules out the first type of error. Non-random errors ipso facto become evidence of "irrationality."
   F. But merely defining systematic errors as "irrational" is hardly evidence that they don't exist on a wide scale. Maybe RE is false, and in that sense, people are not rational. It is an empirical question.
   G. There are weaker definitions of rationality that allow mere ignorance to co-exist with systematic error.
      1. Bayesian rationality, for example, merely demands that people update their beliefs in a certain way, but puts no constraints on their priors. These may be wildly unrealistic.
   H. A still weaker sense of rationality: truth-seeking. However deluded they are, agents qualify as long as they *want* to have true beliefs.
   I. These weaker senses of irrationality still have *some* connection to systematic error. If you do not update your beliefs conditional on

evidence, or if you do not care about truth, you are more likely to have wildly unrealistic views.

J. If you switch to a non-RE definition, you can save “rationality,” but rationality is no longer enough to make democracy work.

K. In practice, most economists do equate “rationality” with RE, so I will stick with this definition throughout the lecture.

V. Rational Ignorance Versus Rational Irrationality

A. What reason is there to believe that the rational expectations assumption is true?

B. The main argument is that systematic errors are **costly**, so people try to:
   1. Avoid them in the first place.
   2. Learn from the systematic mistakes they do happen to make.

C. Big problem here: Some systematic errors are less costly than others, and some can hardly be called costly at all.

D. One of my main ideas: Just as economists think of agents weighing the costs and benefits of *information*, so too can we think of agents weighing the costs and benefits of *rationality*. Just as it is sometimes rational to be *ignorant* (have little information), it may sometimes be rational to be *irrational* (deviate from full rationality).
   1. Psychological interpretation?

E. In other words, we can think of irrationality as a normal good. Why does anyone want this "good"?
   1. Big reason: People derive comfort, security, and sense of identity from their belief structure – and rational thinking is often hard, painful, discouraging work.
   2. Indirect reason: Other people you depend on may treat you differently depending on your beliefs.
   3. For more: See Mosca, *The Ruling Class*, chapter 7 (on the syllabus)

F. What is the "price" of irrationality? It is the material success that you give up in order to retain systematically mistaken beliefs.

G. Writing down an individual's "demand for irrationality" curve for a given issue is easy. Just put quantity of irrationality on the x-axis, and the implicit price of irrationality on the y-axis.
   1. Neoclassical demand for irrationality
   2. Near-neoclassical demand for irrationality

H. When the price of irrationality is high - as it often will be - people consume less. Perhaps they consume none at all - on at least some issues, they might be fully rational.

I. When the price of irrationality is low, people consume more. When irrationality is completely free, people stick with whatever belief makes them most happy, however crazy.

J. Remember our old friend, the probability of voter decisiveness?

K. Immediate implication: The expected price of voter irrationality is essentially zero, so we should not be surprised if voters hold highly irrational beliefs!
L. Question: How is this different from expressive voting?
M. Answer: Expressive voting says that people don't really *care* if policies work. Rational irrationality says people believe their favored policies *do* work, but have irrational beliefs about what works!
    1. Ex: The public reaction to WWI.

V. Systematically Biased Beliefs About Economics
A. There are many subject matters where irrational beliefs may lead to inefficient policy.
B. But one subject matter that seems especially interesting for public choice is economics itself.
    1. Most policy decisions of modern government have significant economic content.
    2. Economists have written about economic misconceptions for hundreds of years - most famously, French economist Frederic Bastiat.
C. I have done a lot of empirical work on this topic; chapter 3 of *The Myth of the Rational Voter* summarizes it.
    1. Data: the *Survey of Americans and Economists on the Economy* (SAEE). 1510 members of the general public, 250 Ph.D. economists.
D. Standard method of testing for irrationality: Look for differences in mean beliefs of laypeople and experts.
E. Complication: Critics of economists claim that it is the economists who are biased rather than the public!
    1. Self-serving bias
    2. Ideological bias
F. In my empirical work, however, I am able to show that large systematic belief differences persist *controlling for* self-serving and ideological bias. [Tables]
G. What main clusters of systematic belief differences emerge?
    1. Anti-market bias
    2. Anti-foreign bias
    3. Make-work bias
    4. Pessimistic bias
H. What kinds of inefficient policies could each of these four categories explain?

VI. Group Differences in Economic Beliefs

A. If you buy my evidence on systematically biased beliefs, the distribution of bias becomes a pressing issue for democracy: Is bias uniformly distributed, or concentrated in specific parts of the population?

B. While biases appear in all major segments of the public, the following factors reduce bias in the SAEE:

1. Education
2. Being male
3. Job security
4. Income *growth*

C. What does NOT make people think like economists?

1. Income *level*
2. Conservatism

D. What does this mean? Presumably, when median economic literacy falls (whether due to franchise rules or personal choice), policy gets worse, because the median voter's biases are more severe and politicians have to cater to them.

1. Ex: Policy is probably better than it would otherwise be due to the higher turnout of the well-educated.

E. In subsequent work with Stephen Miller ("Intelligence Makes People Think Like Economists"), we found that much of the apparent effect of education is actually an effect of IQ. IQ is the strongest overall predictor of "thinking like an economist."

F. Controlling for IQ, education is the second strongest predictor of economistic thinking – and remains the strongest antidote to anti-foreign bias.

VII. Systematically Biased Beliefs About Other Subjects?

A. Foreign policy?

B. A large literature in political science documents a "rally-round-the-flag effect." FDR's approval jumped 12 percentage-points after Pearl Harbor. Bush's approval rose 35 percentage-points after 9/11! This seems hard for a rational voter model to explain. Why should failure make leaders *more* popular? Even if you think you have an answer, why would this extra popularity *predictably* erode?

C. Other misconceptions about international affairs also seem to have a strong effect on voter preferences. Ex: "According to an October 21, 2004 Harris Poll, 52 percent of those who preferred Bush thought that Saddam had helped plan and support the hijackers who attacked the U.S. on September 11 (it was 23 percent for those who preferred Kerry) and 58% of those who preferred Bush thought that Iraq had weapons of mass destruction when the U.S. invaded (it was 16% for those who preferred Kerry). Neither of these assertions is true." (Donald Wittman, "Reply to Caplan" in *EJW*) Original survey at: http://www.harrisinteractive.com/harris_poll/index.asp?PID=508

D. Misconceptions are not marginal. Consider Hitler's argument for conquest: Germany won't be able feed itself with its current land area, and trade is not a viable solution. It was a key motive for World War II, yet after the war, Germany grew rich following the strategy that Hitler dismissed.

E. Global warming? A strong consensus of climate scientists does agree that it is a real and serious problem. (See Figures 28-30, http://dvsun3.gkss.de/BERICHTE/GKSS_Berichte_2007/GKSS_2007_11.pdf).

F. If laymen accepted the expert consensus, would they favor different policies?

G. Other areas?

VIII. The Enlightened Preference Approach

A. In political science, there is a large literature on "Enlightened Preferences" that also seriously undermines the Miracle of Aggregation. Best summary of the literature: Scott Althaus' *Collective Preferences in Democratic Politics*.

B. Basic idea: Regress policy preferences on standard variables *and* a measure of objective political knowledge. Then simulate the distribution of Enlightened Preferences – i.e. what preferences people would have if everyone had the highest level of objective political knowledge.

C. Complication: You can allow the coefficient on political knowledge to vary by sub-group. Ex: Maybe well-informed people with high income are *less* supportive of progressive taxation than poorly-informed people with high income, but well-informed people with low income are *more* supportive of progressive taxation than poorly-informed people with low income.

D. According to the Miracle of Aggregation, Enlightened Preferences will have the same mean as actual preferences.

E. Key finding #1: The Miracle of Aggregation fails badly again. Enlightened preferences are almost always noticeably different from actual preferences.

F. Key finding #2: Knowledge usually works in the same direction for diverse sub-groups. In fact, the absolute magnitude of the coefficient is often larger for the groups that normally oppose a given policy. Example: Preferences for free markets vs. government.

G. Key finding #3: Enlightened preferences are more economically conservative and socially libel than actual preferences. (summary table, p.129)

H. Examples (pp.109, 111, 115, 116)

I. Closing thought: Enlightened Preference results are based on questions that are easy in absolute terms. So the “maximum” level of knowledge in the simulations is still fairly low. What would estimated Enlightened Preferences be if the questions were much more demanding?

Table 3

Benchmark Results – Ordered Logits on *Econ*

	Variable	*Econ* Coef.	z–Stat
1	*TAXHIGH*	−1.95	−14.14
2	*DEFICIT*	−1.86	−13.89
3	*FORAID*	−3.99	−19.91
4	*IMMIG*	−2.74	−16.28
5	*TAXBREAK*	−1.55	−12.08
6	*INADEDUC*	0.12	0.84
7	*WELFARE*	−2.36	−17.12
8	*AA*	−1.80	−10.89
9	*HARDWORK*	−1.47	−11.60
10	*REG*	−0.66	−5.21
11	*SAVINGS*	0.25	1.90
12	*PROFHIGH*	−3.27	−17.10
13	*EXECPAY*	−2.33	−16.98
14	*BUSPROD*	0.73	5.41
15	*TECH*	−2.77	−17.50
16	*OVERSEAS*	−3.04	−19.81
17	*DOWNSIZE*	−2.72	−18.54
18	*COMPEDUC*	−1.04	−7.88
19	*TAXCUT*	−0.99	−7.26
20	*WOMENWORK*	0.93	5.94
21	*TECHGOOD*	2.72	6.52
22	*TRADEAG*	1.90	8.44
23	*DOWNGOOD*	1.64	12.22
24	*CHANGE20*	2.98	10.30
25	*TRADEJOB*	1.89	14.17
26	*WHYGASSD*	3.08	14.74
27	*PRES*	0.05	0.47
28	*GASPRICE*	−3.12	−19.38
29	*NEWJOB*	1.67	12.23
30	*GAP20*	0.74	3.80
31	*INCOME20*	1.91	14.53
32	*WAGE20*	1.25	9.35
33	*NEED2EARN*	−0.81	−4.65
34	*STAN5*	1.31	9.86
35	*CHILDGEN*	0.53	4.12
36	*CHILDSTAN*	0.00	−0.02
37	*CURECON*	0.81	6.38

Table 5

Controlling for Self-Serving Bias – Ordered Logits on Race Dummies, *Age*, Age^2, *Male*, *Jobsecurity*, *Yourlast5*, *Yournext5*, *Income*, and *Econ* (Comparisons Set Variables Other than *Econ* Equal to Median Sample Values)

				Mean Belief	
No.	Variable	Econ Coef.	z-Stat	Economists	General Public
1	*TAXHIGH*	−1.40	−7.90	0.92	1.43
2	*DEFICIT*	−1.88	−10.09	1.15	1.75
3	*FORAID*	−3.26	−14.25	0.25	1.43
4	*IMMIG*	−2.20	−10.86	0.30	1.08
5	*TAXBREAK*	−0.70	−4.16	0.82	1.09
6	*INADEDUC*	0.30	1.58	1.62	1.53
7	*WELFARE*	−1.56	−8.78	0.91	1.49
8	*AA*	−1.73	−8.54	0.24	0.77
9	*HARDWORK*	−1.41	−8.32	0.88	1.46
10	*REG*	−0.64	−3.79	1.03	1.27
11	*SAVINGS*	0.19	1.11	1.39	1.34
12	*PROFHIGH*	−2.57	−11.39	0.24	1.09
13	*EXECPAY*	−1.67	−9.38	0.83	1.49
14	*BUSPROD*	0.89	5.09	1.44	1.14
15	*TECH*	−1.89	−10.03	0.40	1.05
16	*OVERSEAS*	−2.48	−12.96	0.61	1.52
17	*DOWNSIZE*	−2.11	−11.46	0.61	1.41
18	*COMPEDUC*	−0.60	−3.41	1.24	1.45
19	*TAXCUT*	−0.93	−5.23	1.12	1.50
20	*WOMENWORK*	0.86	4.36	1.68	1.43
21	*TECHGOOD*	2.29	4.37	1.95	1.67
22	*TRADEAG*	1.41	5.43	1.78	1.34
23	*DOWNGOOD*	1.41	7.92	1.34	0.68
24	*CHANGE20*	2.34	7.33	1.89	1.29
25	*TRADEJOB*	1.54	8.86	1.33	0.69
26	*WHYGASSD*	2.79	11.05	0.85	0.26
27	*PRES*	0.27	1.73	0.92	0.81
28	*GASPRICE*	−2.06	−10.39	0.88	1.56
29	*NEWJOB*	1.39	7.34	0.88	0.34
30	*GAP20*	0.84	3.45	1.86	1.71
31	*INCOME20*	1.50	8.40	0.95	0.38
32	*WAGE20*	0.71	3.86	0.52	0.31
33	*NEED2EARN*	−0.42	−1.78	0.81	0.87
34	*STAN5*	1.38	7.81	1.30	0.81
35	*CHILDGEN*	1.14	6.53	1.29	0.81
36	*CHILDSTAN*	0.65	3.08	1.43	1.19
37	*CURECON*	0.35	2.10	2.83	2.65

Table 6

Controlling for Ideological Bias – Ordered Logits on *Dem*, *Rep*, *Othparty*, *Ideology*(1-*Othideol*), *Othideol*, and *Econ* (Comparisons of Economists and General Public set all variables other than *Econ* equal to the median sample values – *Ideology* = Moderate, *Party* = Independent)

				Mean Belief			
No.	Variable	Econ Coef.	z-Stat	Economists	General Public	Left-wing Ideologues	Right-wing Ideologues
1	*TAXHIGH*	–1.93	–13.75	*0.80*	1.50	*1.06*	1.79
2	*DEFICIT*	–1.86	–13.56	*1.16*	1.75	*1.61*	1.81
3	*FORAID*	–4.04	–19.43	0.16	1.55	1.43	1.58
4	*IMMIG*	–2.73	–15.86	*0.24*	1.20	*1.02*	1.37
5	*TAXBREAK*	–1.68	–12.58	*0.62*	1.27	1.58	*1.00*
6	*INADEDUC*	0.06	0.43	1.59	1.56	1.66	1.47
7	*WELFARE*	–2.33	–16.54	*0.74*	1.61	*1.32*	1.82
8	*AA*	–1.79	–10.42	*0.23*	0.76	*0.41*	1.06
9	*HARDWORK*	–1.46	–11.20	*0.81*	1.43	*1.15*	1.65
10	*REG*	–0.52	–3.96	*1.01*	1.20	*0.78*	1.62
11	*SAVINGS*	0.29	2.16	1.49	1.37	1.34	1.43
12	*PROFHIGH*	–3.46	–17.35	*0.17*	1.28	1.51	*1.00*
13	*EXECPAY*	–2.52	–17.63	*0.66*	1.61	1.78	*1.34*
14	*BUSPROD*	0.76	5.48	1.43	1.17	1.19	1.22
15	*TECH*	–2.79	–17.27	0.28	1.25	1.31	1.20
16	*OVERSEAS*	–3.14	–19.81	*0.51*	1.62	1.63	*1.50*
17	*DOWNSIZE*	–2.83	–18.65	*0.47*	1.51	1.66	*1.34*
18	*COMPEDUC*	–1.21	–8.81	*1.18*	1.59	1.76	*1.23*
19	*TAXCUT*	–0.88	–6.30	*1.08*	1.45	*1.02*	1.78
20	*WOMENWORK*	0.84	5.23	*1.75*	1.53	*1.71*	1.17
21	*TECHGOOD*	2.90	6.34	*1.97*	1.54	1.55	*1.63*
22	*TRADEAG*	1.84	8.13	*1.84*	1.32	*1.48*	1.25
23	*DOWNGOOD*	1.75	12.60	*1.34*	0.56	0.44	*0.84*
24	*CHANGE20*	2.99	10.28	1.91	1.13	1.18	1.20
25	*TRADEJOB*	1.92	14.09	1.43	0.62	0.60	0.68
26	*WHYGASSD*	3.21	14.59	*0.91*	0.29	0.19	*0.34*
27	*PRES*	0.08	0.63	0.87	0.83	0.94	0.96
28	*GASPRICE*	–3.11	–19.00	0.63	1.68	1.62	1.73
29	*NEWJOB*	1.79	12.61	*1.10*	0.34	0.24	*0.54*
30	*GAP20*	0.57	2.84	*1.87*	1.79	*1.90*	1.37
31	*INCOME20*	2.00	14.69	*1.13*	0.36	0.27	*0.52*
32	*WAGE20*	1.34	9.73	*0.76*	0.31	0.23	*0.47*
33	*NEED2EARN*	–0.99	–5.44	*0.72*	0.88	0.96	*0.74*
34	*STAN5*	1.36	9.93	1.40	0.89	0.87	1.00
35	*CHILDGEN*	0.61	4.56	1.28	1.03	0.99	1.13
36	*CHILDSTAN*	0.02	0.15	1.31	1.29	1.28	1.31
37	*CURECON*	0.80	6.14	*2.93*	2.51	*2.76*	2.54

italic indicates economists and ideologues think alike

Table 7.

Controlling for Self-Serving Bias, Ideological Bias, and Education: Ordered Logits on Race Dummies, *Age*, Age^2, *Male*, *Dem*, *Rep*, *Othparty*, *Ideology*(1-*Othideol*), *Othideol*, *Jobsecurity*, *Yourlast5*, *Yournext5*, *Income*, *Education*, and *Econ* (Comparisons Set Variables Other than *Econ* and *Education* Equal to Median Sample Values)

						Mean Belief		
No.	Variable	*Econ* Coef.	z-Stat	Educ Coef.	z-Stat	PhD Economists	Non-Economists with Post-Graduate	Non-Economists with Primary Only
1	*TAXHIGH*	**−0.88**	**−4.71**	**−0.29**	**−7.35**	0.89	1.21	1.74
2	*DEFICIT*	−1.78	−9.01	−0.04	−0.77	1.17	1.74	1.78
3	*FORAID*	**−2.95**	**−12.38**	**−0.28**	**−6.81**	0.22	1.26	1.76
4	*IMMIG*	**−1.78**	**−8.41**	**−0.31**	**−8.34**	0.23	0.79	1.52
5	*TAXBREAK*	**−0.61**	**−3.42**	**−0.22**	**−5.62**	0.70	0.91	1.40
6	*INADEDUC*	0.26	1.32	−0.03	−0.83	1.60	1.52	1.57
7	*WELFARE*	**−1.07**	**−5.72**	**−0.28**	**−6.47**	0.85	1.26	1.75
8	*AA*	**−1.35**	**−6.29**	**−0.24**	**−6.42**	0.21	0.57	1.08
9	*HARDWORK*	**−1.19**	**−6.65**	**−0.11**	**−2.97**	0.84	1.32	1.56
10	*REG*	−0.17	−0.98	−0.20	−5.38	1.02	1.08	1.51
11	*SAVINGS*	0.20	1.11	0.04	0.99	1.42	1.35	1.26
12	*PROFHIGH*	**−2.54**	**−10.78**	**−0.18**	**−4.79**	0.19	0.97	1.37
13	*EXECPAY*	**−1.74**	**−9.11**	**−0.15**	**−3.50**	0.74	1.42	1.70
14	*BUSPROD*	0.98	5.33	−0.03	−0.83	1.43	1.09	1.16
15	*TECH*	**−1.55**	**−7.86**	**−0.30**	**−8.11**	0.32	0.80	1.47
16	*OVERSEAS*	**−2.32**	**−11.58**	**−0.20**	**−4.80**	0.58	1.43	1.76
17	*DOWNSIZE*	**−2.15**	**−11.03**	**−0.08**	**−2.15**	0.54	1.34	1.50
18	*COMPEDUC*	−0.77	−4.09	−0.05	−1.22	1.23	1.50	1.59
19	*TAXCUT*	−0.71	−3.78	0.00	0.05	1.19	1.48	1.47
20	*WOMENWORK*	**0.57**	**2.77**	**0.09**	**2.24**	1.71	1.55	1.40
21	*TECHGOOD*	**2.14**	**4.03**	**0.12**	**2.75**	1.95	1.70	1.48
22	*TRADEAG*	**1.08**	**4.01**	**0.22**	**5.74**	1.82	1.54	0.95
23	*DOWNGOOD*	1.51	8.01	0.00	−0.02	1.34	0.63	0.63
24	*CHANGE20*	**2.23**	**6.86**	**0.10**	**2.71**	1.90	1.34	1.07
25	*TRADEJOB*	**1.33**	**7.26**	**0.19**	**5.01**	1.38	0.83	0.41
26	*WHYGASSD*	**2.67**	**10.13**	**0.17**	**3.81**	0.89	0.36	0.17
27	*PRES*	0.29	1.73	0.06	1.64	0.86	0.74	0.61
28	*GASPRICE*	**−1.73**	**−8.34**	**−0.19**	**−4.24**	0.83	1.42	1.74
29	*NEWJOB*	1.43	7.05	0.09	1.95	0.96	0.36	0.22
30	*GAP20*	0.39	1.51	0.16	3.48	1.88	1.83	1.65
31	*INCOME20*	1.64	8.61	−0.04	−0.86	0.95	0.34	0.41
32	*WAGE20*	0.92	4.69	−0.08	−1.86	0.52	0.26	0.39
33	*NEED2EARN*	−0.54	−2.13	−0.07	−1.17	0.77	0.85	0.90
34	*STAN5*	*1.54*	*8.26*	*−0.08*	*−2.31*	1.27	0.72	0.89
35	*CHILDGEN*	*1.44*	*7.82*	*−0.18*	*−5.17*	1.23	0.63	1.09
36	*CHILDSTAN*	0.77	3.35	−0.03	−0.63	1.44	1.15	1.24
37	*CURECON*	0.31	1.79	−0.03	−0.91	2.76	2.59	2.68

bold indicates economists and the more educated think alike;
italics indicates economists and the less educated think alike.

Figure 1
Percent Approving of the President During Three Successful Foreign Crises

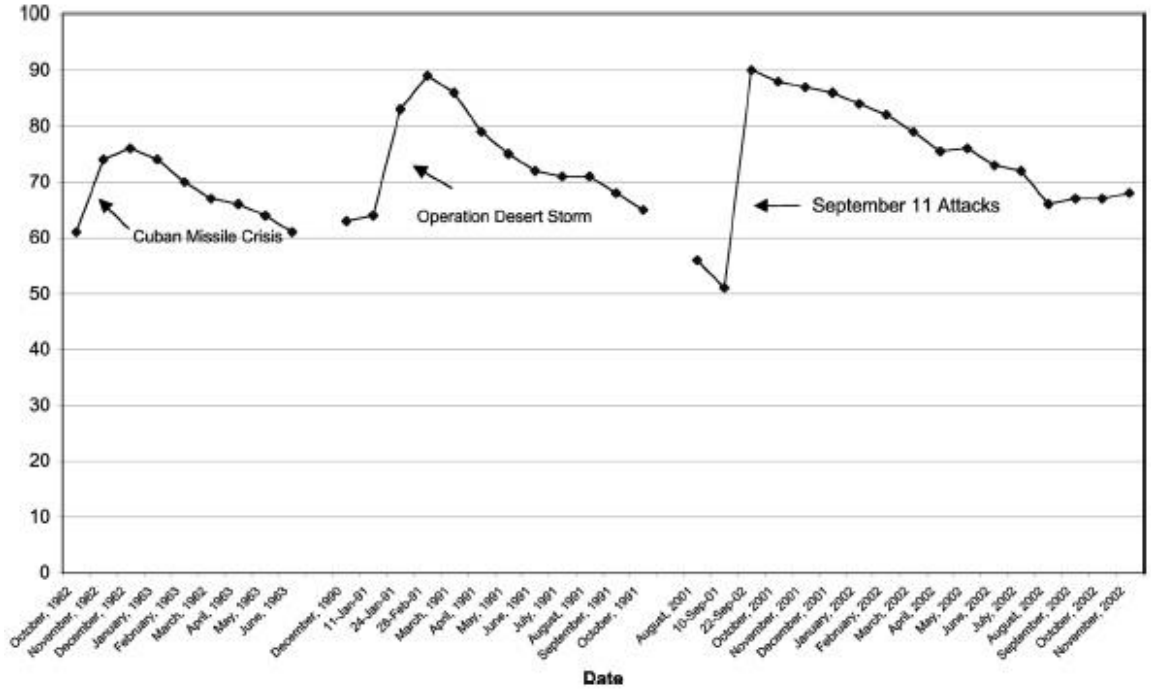


Figure 28. We can say for certain that global warming is a process already underway.

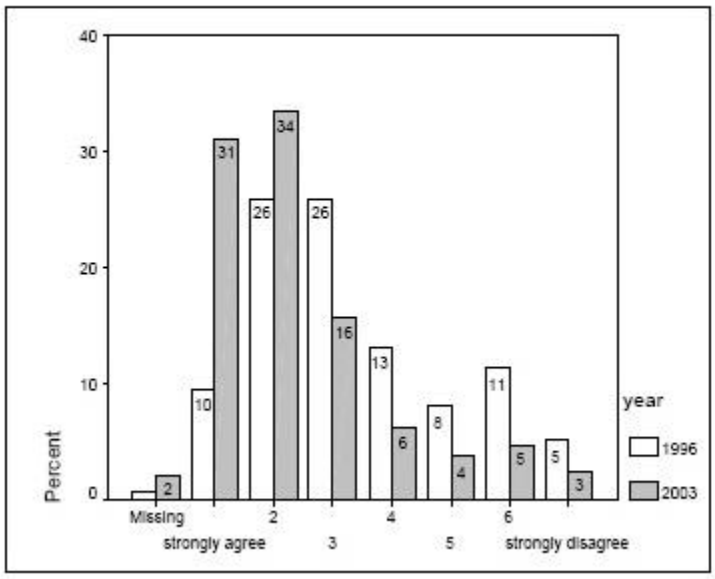


Figure 29. How much do you think global climate change is one of the leading problems facing humanity?

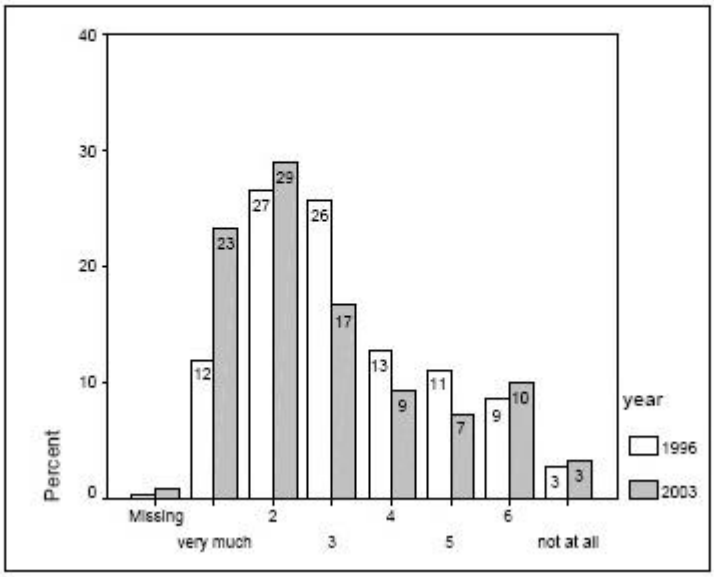


Figure 30. Climate change is mostly the result of anthropogenic causes.

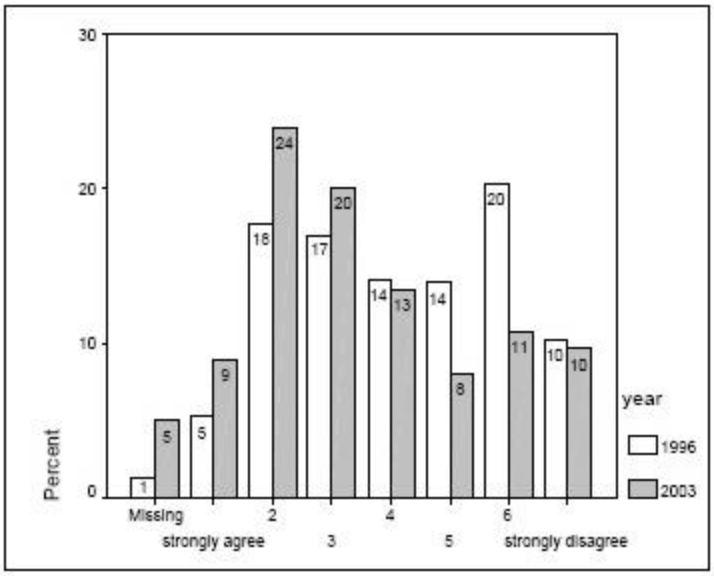
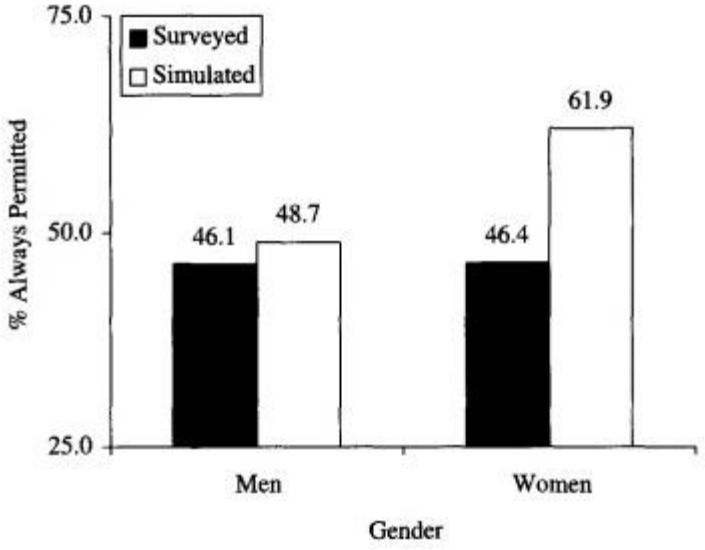


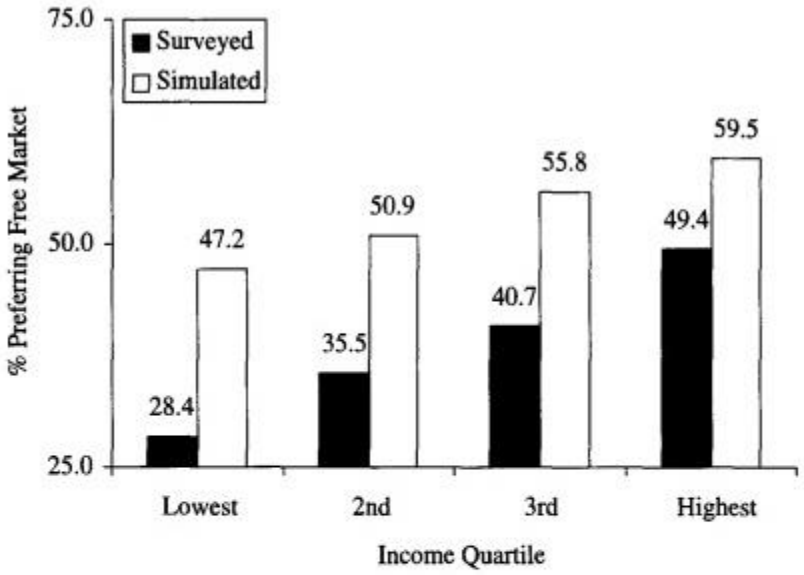
TABLE 4.2. *Qualitative differences between surveyed and fully informed collective preferences*

Question Type	Fully Informed Opinion Relative to Surveyed Opinion
Approval	
Congressional	Less approving
Presidential	Less approving
Presidential policy	Less approving
Policy	
Abortion	More pro-choice
Affirmative action	More supportive of the principle of affirmative action, less supportive of specific types of remedial solutions
Child care	More supportive of parental leave
Crime/Social unrest	Less supportive of increasing spending to reduce crime, drugs, and homelessness, but less supportive of punitive solutions to crime
Education	Less supportive of prayer in schools
Elder care	Less supportive of expanding Social Security and Medicare
Environmental	Less supportive of doing more to protect environment
Fiscal	Less supportive of cutting taxes; more willing to cut domestic programs and pay higher taxes to reduce federal budget deficit; less supportive of raising taxes to fund domestic programs
Foreign	More interventionist in general, more dovish concerning military
Gay rights	More progressive
Health	More supportive of free market solutions to health insurance problems
Immigration	More progressive
Governance	More libertarian
Other social policy	More supportive of increased spending on space and science research
Welfare	More supportive of decreasing spending on welfare
Value	
Equality	More supportive of equal rights, but not at all costs; less likely to see unequal opportunities as the source of many social problems
Morality	Less supportive of adjusting morals to accommodate changing society, attaches less importance to being tolerant of other people's different moral standards, less supportive of position that newer lifestyles are contributing to social breakdown
Other value	No clear pattern



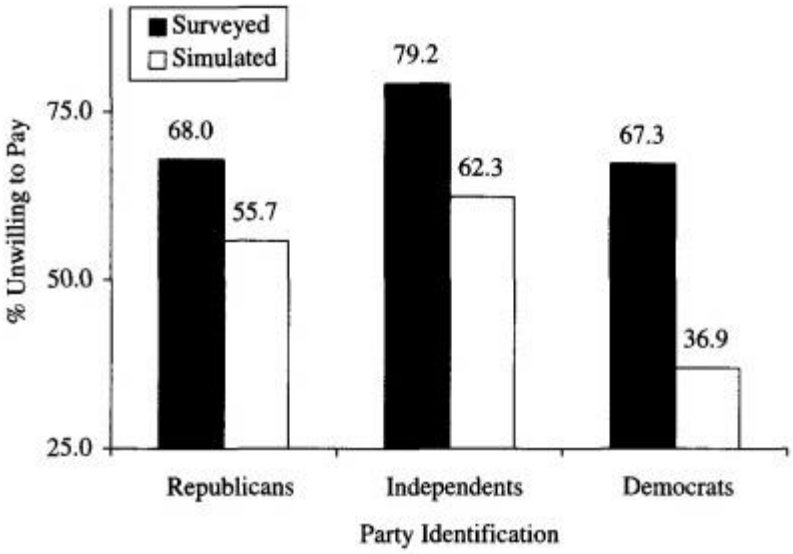
Total Sample	% Always Permitted	% At Least Some Restrictions
Surveyed Marginals	46.2%	53.8
Simulated Marginals	55.7%	44.3

FIGURE 4.1. Surveyed and fully informed opinion on abortion rights



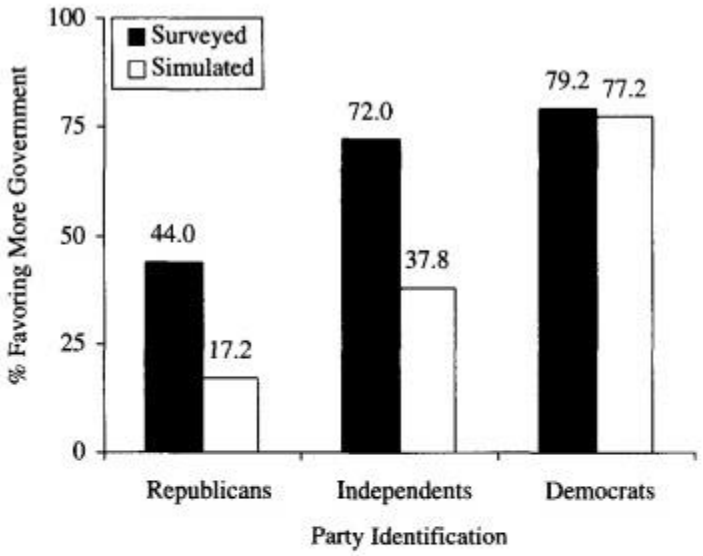
Total Sample	% Strong Government	% Free Market
Surveyed Marginals	61.7%	38.3
Simulated Marginals	46.8%	53.2

FIGURE 4.2. Surveyed and fully informed opinion on free market solutions to economic problems



Total Sample	% Unwilling to Pay More	% Willing to Pay More
Surveyed Marginals	68.9%	31.1
Simulated Marginals	47.6%	52.4

FIGURE 4.3. Surveyed and fully informed opinion on increasing taxes to reduce the deficit



Total Sample	% More Government	% Less Government
Surveyed Marginals	64.9%	35.1
Simulated Marginals	49.3%	50.7

FIGURE 4.4. Surveyed and fully informed opinion on favoring more government

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 11: Behavioral Political Economy

I. What Is Behavioral Political Economy?
   A. The key intuition behind "behavioral economics": The behavior of flesh-and-blood people is very different from the behavior of rational actors. So if we want to understand the world, we need to spend more time studying human psychology, and less time analyzing irrelevant models.
   B. The "behavioral" revolution has made big inroads in almost every area of applied economics – except the economics of politics.
   C. Even if I'm wrong to think that people are especially irrational in politics, this is a puzzling oversight. And if I'm right, it's perverse!
   D. This week we're going to try to correct this neglect of behavioral political economy.
      1. We'll begin by putting irrational voters into standard public choice models to see what happens.
      2. Then we'll look at some "advanced prototype" models that use specific assumptions about voter irrationality to explain otherwise puzzling facts about politics.

II. Irrationality in the Median Voter Model
   A. How does irrationality affect policy in a simple median voter framework? Let's consider two simple cases:
      1. Case 1: Voters are identical in all respects - including identical near-neoclassical demand-for-irrationality curves.
      2. Case 2: Voters are identical except that they have different near-neoclassical demand-for-irrationality curves.
   B. Case 1: Voters all want to maximize social income, but also want to believe that protectionism works.
      1. On one graph, we can show the unbiased and biased estimates of the wealth-maximizing level of protection.
      2. On the second graph, we can contrast the optimal and the winning platforms.
   C. Case 2: Voters all want to maximize social income, but the median voter wants to believe that protectionism works.
      1. On one graph, we can show the unbiased estimate and the biased median estimate of the wealth-maximizing level of protection.
      2. On the second graph, we can contrast the optimal and the winning platforms.

III. Application: Protectionism
   A. Public choice economists have typically seen protectionism as a product of special interests taking advantage of the public's rational

ignorance.

B. Big puzzle for this theory: Protectionism is popular!

C. The median voter model with voter irrationality can easily explain the facts:
   1. People hold rationally irrational beliefs about trade policy, as the SAEE and many other data sources confirm.
   2. Politicians offer protectionist policies to get their votes.

D. The real puzzle: Why isn't policy far more protectionist than it is?

IV. The Inefficiency of Political Irrationality

A. Economists' efficiency calculations must count the consumption value of irrationality as a benefit. However, this hardly implies an efficient outcome.

B. Why? Voters enjoy the full benefit of their own irrationality, but pay only an infinitesimal fraction of the cost. Each voter subconsciously thinks "My irrationality makes no perceptible difference on policy, so I might as well believe whatever makes me feel best."

C. If enough voters rely on systematically biased beliefs to decide how to vote, disastrous policies may be adopted.
   1. Ex: With enough protectionist voters, protectionist policies may prevail.

D. Rational irrationality, like expressive voting, even allows for "inefficient unanimity." Ex: Suppose voters are trying to ascertain whether their nation will be able to defeat a hated national enemy.

G. Each voter is willing to pay up to $100 in order to believe that "One patriot can lick twenty foreigners, so victory is assured." If they hold this belief, they vote Yes.

H. But if a majority votes Yes, and war is actually declared, the country will be thrown into a bloody conflict that costs each voter an average of $100,000.

I. Each person believes in his country's invincibility so long as $p^* -\$100{,}000 + \$100 > 0$.

J. Since everyone is identical by assumption, it follows that as long as $p < .001$, 100% of all voters vote for war, even though the net per-capita social benefit of war is -$99,900!

K. How is this possible? There are massive externalities of irrationality. Just as all polluters can be better off if everyone pollutes less, all voters can be better off if everyone consumes less irrationality.

V. The Interaction Between Voter Motivation and Cognition

A. When they analyze politics, economists have two standard assumptions:
   1. Selfish motivation
   2. Rational cognition

B. These two assumptions imply four logical possibilities. How does each play out in a median voter model?

C. Unselfish motivation and rational cognition imply unanimous voter

support for efficient policy; selfish motivation and rational cognition imply less favorably results.

D. Most critics of public choice blame its pessimistic conclusions on the assumption of selfish motivation. They have a point, but Wittman's work suggests that they over-state their case. Selfish rational voting leads to policies at most mildly less efficient than unselfish rational voting.

E. What happens if unselfish motivation is combined with irrational beliefs? Very bad things. Choosing the optimal policy given wildly erroneous assumptions normally leads to very bad policies.

F. In fact, selfish motivation *probably* partially mitigates the harm of irrational beliefs. Why? Heterogeneous interests reduce the support for so-called "socially beneficial" policies.
   1. Ex: Gas price controls

G. In sum, then, a plausible welfare ordering looks like this:
   1. Unselfish motivation, rational cognition
   2. Selfish motivation, rational cognition
   3. Selfish motivation, irrational cognition
   4. Unselfish motivation, irrational cognition

H. Neither selfish motivation nor rational cognition hold up empirically, suggesting that we are in the worst quadrant.

VI. The Supply Side of Politics

A. What does rational irrationality say about politicians? Politicians have strong incentives to be rational about *how to get elected*.

B. Their incentive to rationally assess the *effects* of policies are much less clear. If voters rate politicians on the sole basis of agreement with their policy views, politicians have *no* incentive to rationally assess policies' effects.

C. If voters can detect sincerity, politicians have a *negative* incentive to rationally assess policies' effects!

D. However, if voters also reward politicians for their *results*, politicians get some electoral benefit from second-guessing their constituents. But does this benefit outweigh its costs?

E. Added difficulty: Do voters at least have rational beliefs about which politicians affect which outcomes? My work in progress says they don't.

F. Politicians are an extremely select group. But they're selected for persuasively telling voters what they want to hear, not their high-quality analysis of public policy.

G. Do advisors help? Again, it all depends on how voters reward politicians. If they reward politicians who agree with their policy views, politicians want advisors to figure out the most compelling way to tell voters what they want to hear – not what works.

H. If you were a politician, how would you sell more immigration to the American public? Drug legalization? A free market in human markets? If you were an advisor, how would you sell them to a

politician?

VII. Irrationality and Slack
- A. Economists usually blame political failure on “agency problems,” not voter irrationality.
- B. My claim: Democratic agency problems are largely the result of the *principals*’ negligence. If voters were rational, these problems would have been largely solved before they started.
- C. As we’ve discussed, rational voters have powerful tools to discipline politicians, even in the face of severe ignorance and high monitoring costs:
  1. Use Beckerian punishment strategies.
  2. Reward/blame the top.
  3. When in doubt, say no.
  4. Give the Miracle of Aggregation a hand: Vote only on what you know.
- D. If these strategies seem overly intellectual, note that voters seem to understand them well enough to use them on special occasions – most notably to punish offensive remarks.
- E. The existence of a big bureaucratic pyramid does not fundamentally change anything. A competent politician’s most basic order to his underlings is: “Do what I would have done if I knew all the details.” So if a subordinate does something voters don’t like, his superior either…
  1. wanted him to do it,
  2. managed him incompetently, or
  3. is a bad judge of character.
- F. This doesn’t mean that agency problems don’t exist, just that you need voter irrationality to explain big, persistent agency problems.
- G. Ex #1: Rational voters would not accept “buck-passing” or “plausible deniability.” They would roll their eyes if a president tried to blame an underling for e.g. torture. (“I’m shocked, simply shocked…!”)
- H. However, irrational voters might be willing to buy lame excuses – ensuring a steady supply of deception.
- I. Ex #2: Many models of political failure require the assumption that politicians can’t be paid for performance. So why don’t voters just pay them for performance?
- J. Perhaps voters prefer to see politicians as selfless servants of the public good, so they see no need for better incentives. Given public choice economists efforts to disabuse the world of “politics as romance,” it is hard to deny that this idea is widespread.

VIII. Answering Wittman, II
- A. To my mind, rational irrationality is the second key pillar of a thoughtful answer to Wittman.
- B. Yes, public choice arguments frequently require "extreme voter stupidity," as Wittman charges. But so what? Voters - even smart

ones - *become* extremely stupid (“irrational”) when they deliberate on political/economic questions.

C. Voter irrationality is both:
   1. Plausible in theory
   2. Easy to detect empirically on a large scale

D. Key asymmetry between politics and markets: Incentives for rationality. In markets, ignorant actors do their best with what they know. In politics, they scarcely try.

E. Rational irrationality helps explain why politicians cater to voters' prejudices rather than trying to "educate" them. Voters like candidates who share their confusions, not pedants who lecture them.

G. Can rational irrationality breathe new life into old political failures?
   1. Pork barrel politics
   2. Concentrated interests
   3. Bureaucracy
   4. Political advertising and special interests

H. Wittman has engaged my criticism in a three-round exchange – the first two rounds in *Econ Journal Watch*, and the last round in *Critical Review*. While Wittman has not officially changed his position, I think he has lowered his standard of “rationality” so much that almost anything would be consistent with it. He has even written a paper (“Utility When There is a Preference for Beliefs”) explicitly assuming that people’s beliefs become less rational as the incentive for rationality falls.

IX. Why Isn’t Democracy Worse?

A. Before people study public opinion, they often wonder: “Why is policy so bad?” After studying public opinion, they often wonder: “Why isn’t policy much worse?”

B. Answer #1: The median voter is more educated than the median citizen – and the more educated are less irrational.
   1. How convincing is the Australian counter-example?

C. Answer #2: Voters reward politicians for both policies and results, so politicians deliberately water down the voters’ worst ideas.
   1. Intriguing implication: Voters will dislike politicians because they seem either dishonest or incompetent.

D. Answer #3: Voters’ inept monitoring strategies give politicians and bureaucrats a lot of slack – and on balance they use their slack in the public interest!
   1. Are government economists the real “special interest” behind free trade agreements?

E. Other answers?

X. Availability Cascades

A. Cognitive psychologists have found that people frequently estimate probabilities based upon *how easy it is to think of examples*. Psychologists call this the “availability heuristic.”

B. This often leads to systematically biased estimates. Psychologists call this "availability bias."
C. This bias is normally demonstrated in simple experiments. How does it play out in the real world?
D. One fascinating answer (Kuran and Sunstein): The interaction between availability bias and the media leads to a never-ending series of mass hysterias, or "availability cascades."
E. The cycle of hysteria:
    1. The media gives massive coverage to shocking but rare events in order to get good ratings.
    2. The public watches. Watching makes it easier for the public to think of examples of the events the media covers.
    3. One effect: The public begins to think the problems are quantitatively serious, so it gets easier to sell the public similar stories.
    4. Other effect: Politicians begin trying to solve the "problem" to win votes.
F. Examples:
    1. Nuclear power
    2. Genetically-altered food
    3. Columbine
G. It is easy to combine this with my rational irrationality approach. Mass hysterias provoke strong political responses but weak personal responses because the price of irrationality is lower in the former case.

XI. The Idea Trap
A. Standard finding in growth econ: The convergence hypothesis fails. Poor countries do not on average catch-up to rich countries.
B. However, poor countries do catch-up *if* they have good policies. (Sachs and Warner) Convergence fails because poor countries persistently stick with bad policies.
C. Remember my finding that income *growth* "makes people think like economists"? If we assume that this finding generalizes across countries and over time, a simple model that I call the "idea trap" can explain all these facts.
D. The model: A country has three attributes: growth, policy, and ideas. Each attribute can be good, mediocre, or bad.
E. First two "laws of motion" for countries are obvious.
    1. Good ideas cause good policy (say, through a median voter mechanism).
    2. Good policy causes good growth (near-tautology).
F. The last "law of motion" is non-obvious:
    1. "Negative feedback": Bad growth could lead to good ideas, and vice versa, through a learning/hubris mechanism. In this case, there is a unique equilibrium where growth, policy, and ideas are all mediocre.

2. "Positive feedback": *Good* growth could lead to good ideas, and vice versa. In this case, there are *three* equilibria – one where all variables are good, one where they're all mediocre, and one where they're all bad.

G. The model with positive feedback fits the stylized facts. But it seems counter-intuitive. Don't countries learn from their mistakes?

H. My answer: On average, NO. Disaster usually leads to more disaster, not reform. So when disaster *does* lead to reform, we should interpret it as a positive shock, not an inevitable result of events.

I. Examples:
1. The Great Depression
2. Allende, Pinochet, and Chile
3. The Crisis of 2008?

XII. Government Growth and Crisis

A. Government as a percentage of GDP has grown tremendously since 1900. Other measures of the size of government, economic freedom, etc. reinforce this conclusion.

B. Why has this happened? If you approve of these changes, you'll probably just say that government is a normal good, or that government grew as awareness of market failure grew, or as the majority overcame the plutocrats' conspiracy to keep them down.

C. If you don't approve of these changes, however, you might turn to behavioral political economy for an explanation.

D. Simplest model: Voters have become increasingly irrational over time. But is this plausible?

E. More popular explanation: Higgs' "ratchet model" of government growth from *Crisis and Leviathan*. You don't get big government gradually, or because people wisely see its advantages. Instead, a "crisis" (war or depression) hits, and the frightened population looks to government for salvation. By the time the crisis recedes, people take big government for granted. It might shrink below its peak level, but it never goes back to where it started.

F. What are Higgs' underlying assumptions about voter cognition? They seem similar to those in my idea trap paper – voters are *especially* irrational during a crisis. Then he adds on something like status quo bias to explain why things don't go back to normal later on.

G. Tyler Cowen's alternative: Government growth is driven by technology. Voters were always about as irrational (or rational) as they are now. There has always been a "latent demand" for the welfare state. But it wasn't feasible to create one with the technology of 1850. (Furthermore, wasteful experiments are deadly when income is near subsistence).

H. Cowen also criticizes Higgs' model by pointing to countries like Sweden that stayed out of both world wars still got big government

eventually.

I. Healy and Malhotra's "Myopic Voters and Natural Disaster Spending" (*APSR* 2009) provides an provocative new take on how democracies respond to crises: Voters reward "cure" spending, but not "prevention" spending, even though prevention is much more cost-effective. If you were a politician, how would you respond to these incentives?

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 12: Dictatorship

II. The Stationary Bandit Model
- A. In the minds of many, the only alternative to democracy is dictatorship.
- B. Tullock's Question - "What's so bad about dictatorship anyway?" – highlights the fact that public choice economists have spent little energy analyzing history's *typical* form of government.
- C. Simplest approach: Dictatorship is equivalent to democracy with a single - and perfectly decisive - voter.
- D. All of the usual rules about democracy that hinge on low probability of decisiveness reverse:
  1. Self-interest
  2. Instrumentalism
  3. Rationality
- E. Thus, we should expect dictators to be highly self-interested, but more interested in rationally assessing policies' actual consequences.
- F. Will this lead to bad consequences for the dictators' subjects? According to McGuire and Olson's "stationary bandit model," not necessarily. As long as the dictator knows that he will be around for a long time, it is in his rational self-interest to encourage/allow economic development – to take a smaller slice of the pie in order to make it grow faster.
  1. Alternate perspective: Stationary bandits go to the maximum of the *long-run* Laffer curve instead of the short-run or instantaneous Laffer curve.
- G. Remember the Tiebout model? It is basically a model of dictatorship constrained by mobile capital and labor, and under standard assumptions it yields perfectly competitive results.
  1. If the rulers of Tiebout governments were really dictators, then my arguments about non-profit competition would no longer apply.
- H. In the real world, dictators often respond to the mobility of capital and labor by trying to make them less mobile. The Berlin Wall is the most notorious – but not the most horrific – example.
  1. However, dictators do treat mobile resources better. East Germany rarely forced tourists to become citizens, and Communist governments rarely defaulted on their sovereign debt.
- I. Many dictators go further by making war to get more resources under their control. Why grow when you can *conquer*?

J. Another reason for dictators to stifle growth: Growth leads to contact with the outside world and/or free thought, which tends to undermine the dictator's authority.

III. Constrained Dictatorship and the Paradox of Revolution

A. Very few dictatorships actually fit the "one decisive voter" model, though modern totalitarian regimes – like Stalin's USSR, the Kims' North Korea, and the last years of Hitler's Germany – come close.

B. Almost all dictatorships throughout history have instead been "authoritarian." The dictator has a lot of say, but at least de facto, so do many other actors. The dictator ignores them at his own risk; if he goes over the line, he risks a coup.

C. Most people add that at some point, an abusive dictator would provoke popular resistance.

D. Mises argues that this threat is so strong that dictatorships follow exactly the same policies that democracies would have! I call this his "Democracy-Dictatorship Equivalence Theorem."

E. Tullock, in contrast, argues that collective action problems make popular revolutions virtually impossible.

F. Most political observers believe in the existence of revolutions, so for them Tullock's argument creates a "paradox of revolution" – revolutions seem impossible in theory, yet they occur.

G. For Tullock, however, "popular" revolutions are thinly disguised battles between rival elites. The competing sides solve their collective action problems with selective incentives – better ration cards, promises of post-revolutionary jobs, etc.

H. Trotsky's on Tullock's side: "An army cannot be built without reprisals. Masses of men cannot be led to death unless the army command has the death penalty in its arsenal. So long as those malicious tailless apes that are so proud of their technical achievements - the animals that we call men - will build armies and wage wars, the command will always be obliged to place the soldiers between the possible death in the front and the probable one in the rear."

I. Watered down version of Tullock: Revolutionary movements require true believers to get off the ground, but further growth requires selective incentives.

IV. The Sociopathic Bandit Model?

A. A major complication for economic models of dictatorship: Being dictator effectively makes someone extraordinarily wealthy. The resources of an entire nation are theirs to command.

B. Due to their extreme wealth, they may consume a lot of altruism, expressive considerations, and/or irrationality *despite* their high price.

C. Hence we see all sorts of strange behavior from dictators:

1. Mass murder of seemingly useful subjects.
2. Awe-inspiring parades, monuments, palaces, etc.

3. Bizarre social experiments.
4. And… voluntary reduction to figurehead status!

D. Modern dictators rarely accept figurehead status, but it happened all over 19th-century Europe when traditional monarchs allowed and even urged a move to "constitutional monarchy."
   1. Tullock's explanation: The selective pressure for power-hunger is much weaker in hereditary dictatorships.

E. On balance, then, it is hard to make definite statements about the selfishness, instrumentalism, or rationality of dictatorial versus democratic policy. It's got to be studied empirically.

F. The most convincing claim economic theory has to make about dictatorship: It's a big gamble. Everything depends on the idiosyncrasies of the Leader. This makes sense in theory, and works empirically:

G. Interesting finding #1: Average growth of dictatorships and democracies is the same, but dictatorships have more dispersion. Graph from Almeida and Ferreira (2002):

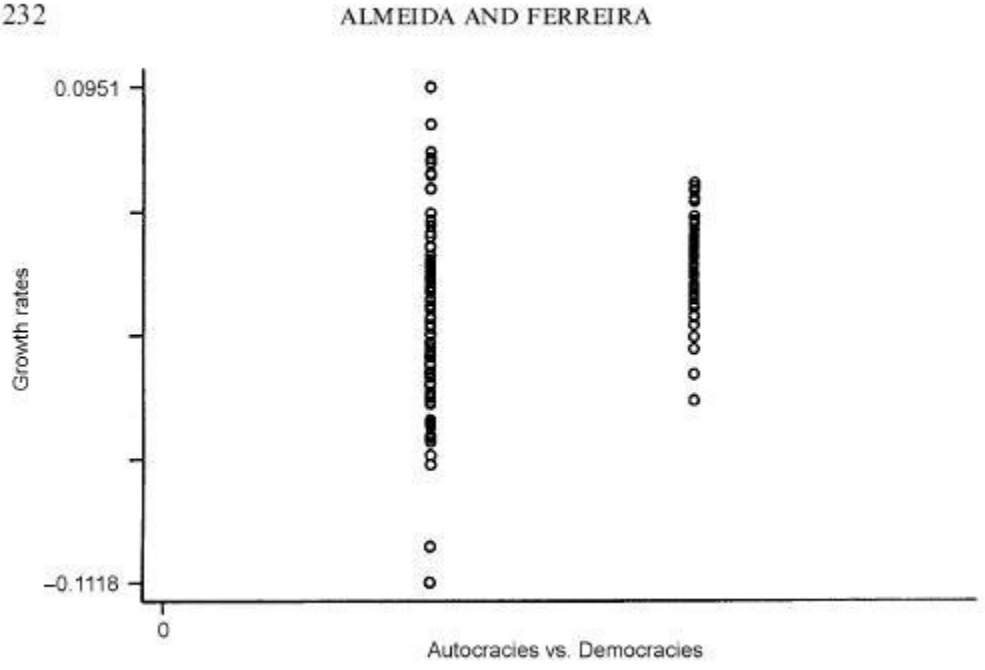


Figure 1. Growth rates for autocratic and democratic countries, 1970–1989.

H. Interesting finding #2: When a dictator *accidentally* dies, growth rates persistently change. When a democratic leader accidentally dies, in contrast, they don't.

V. Totalitarianism

A. Political scientists distinguish between "totalitarian" and "authoritarian" dictatorships. Standard totalitarian checklist courtesy of Richard Pipes:

1. official all-embracing ideology
2. a single party of the elect headed by a “leader” and dominating the state
3. police terror
4. the ruling party's control of the means of communication and the armed forces
5. central command of the economy

B. Since #5 is equivalent to socialism in the traditional sense of the word, many socialists object to this criterion. But it is hard to rebut Trotsky’s explanation: "In a country where the sole employer is the State, opposition means death by slow starvation. The old principle: who does not work shall not eat, has been replaced by a new one: who does not obey shall not eat."

C. One cheer for democracy: Totalitarianism has almost never been established democratically. (Semi-convincing counter-example: Hitler’s Germany). It arises through civil war (USSR, China, etc.) or conquest (Eastern Europe, North Korea).

D. A few analytical narratives on the rise of totalitarianism.

E. A few analytical narratives on the implosion of totalitarianism.

VI. Is Totalitarianism Possible? Economic Calculation Reconsidered

A. Austrian economists were harsh critics of totalitarianism before it existed. So was everyone sensible. The uniquely Austrian objection was that Characteristic #5 (socialism) is “impossible.”

B. Why is socialism impossible? Mises’ original argument:
1. Economic calculation (comparing the cost of different ways of doing the same thing) requires prices.
2. Prices require some kind of market (not necessarily laissez-faire).
3. Under socialism, there is no market, therefore no prices, therefore no calculation.
4. Conclusion: Socialism is impossible.
5. Note: For Mises, “impossible” means total social collapse! “[T]he attempt to reform the world socialistically might destroy civilization. It would never set up a successful socialist community.” “Socialism cannot be realized because it is beyond human power to establish it as a social system.”

C. Many socialists replied that market socialism or faster computers would make socialism possible, but the rejoinders are obvious.

D. My complaint: The argument is fine until the conclusion! The lack of economic calculation makes socialism more *difficult*, but difficult is not impossible.

E. Furthermore, the economic history of socialism shows that:
1. Its biggest disasters – massive famines where millions died – were caused by bad incentives, not lack of calculation.

2. Socialist planners habitually *ignored* capitalist prices; they didn't just preserve socialism by free riding on the price system of the non-socialist world.
3. When socialist societies wanted results, they used strong incentives and got results. See their secret police, border security, militaries, space programs, Olympic teams, and nuclear weapons.

F. Also note: Incentive experiments in Soviet agriculture showed that it was possible to sharply raise output, but the experiments were ignored and their initiators punished.

VII. Democratic Transitions: What Happens?

A. One fact that Mises' Equivalence Theorem can explain, and Tullock can't: When dictatorships peacefully become democracies, policy usually doesn't change that much. Examples:
1. Strong populist back-lash against free-market policies – and election of ex-Communists (and even unrepentant Communists) – in the former Soviet bloc.
2. Chile kept most of Pinochet's economic policies after he relinquished power.
3. Free elections in Palestine did not lead to dovish victory.

B. However, there are many more plausible explanations than Mises' story that dictators are fully constrained by the threat of revolution.

C. The stationary bandit model. Stable dictators, like the median voter, benefit if their country has pro-growth policies.
1. Of course, this model isn't very convincing if you think that both kinds of governments have deeply inefficient policies!

D. Shared preferences. Especially in long-lasting dictatorships, the dictator and the median voter come from the same basic political culture and therefore have similar preferences.

E. Status quo bias. To a large extent, dictatorships successfully brainwash their populations to think that what is, is a pretty good idea.
1. Fascinating result: Alesina and Fuchs-Schündeln (2005) find that East Germans are markedly *more* anti-market than West Germans, even controlling for income. Living under socialist tyranny doesn't make people hate socialism.

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 13: Constitutions

I. The Comparative Institutions Approach Revisited
- A. Remember the Emperor's tale?
- B. After a full semester of public choice, we are now in a much better position to step back and compare institutions.
- C. Dictatorship has obvious problems. How do the problems of democracy compare?
- D. Economically literate defenders of democracy typically focus on government's special ability to supply public goods. After analyzing how democracy actually works, what can we say about this?
- E. If people voted rationally and instrumentally, the public goods argument makes a great deal of sense.
- F. However, since voting is largely expressive and not instrumental, public goods are supplied only by coincidence.
  1. Ex: National defense may have expressive as well as instrumental value.
- G. But: Expressive voting is likely to lead to government involvement in a wide array of "feel-good" issues that have nothing to do with public goods.
  1. Care of the old
  2. Health
  3. Education
- H. Similarly, whenever voters hold systematically mistaken beliefs, we are likely to see government wasting resources or being actively counter-productive.
  1. International trade
  2. Price controls
  3. Labor market regulation
- I. All this adds up to an efficiency case for limiting the scope of democracy in order to keep "political pollution" under control.
- J. Still, if dictatorship and democracy are our only choices, democracy seems like the lesser evil.

II. Alternatives to Democracy and Dictatorship
- A. Is democracy the only alternative to dictatorship? Most countries that we call “democracies” have *many* undemocratic elements, including:
  1. Supermajority rules
  2. Division of powers
  3. Limitations on the *scope* of democracy
  4. Federalism

5. Franchise restrictions – most notably the restriction that only citizens get to vote!
6. Plural voting
7. Judicial review
8. Disproportionate representation
9. Lifetime appointments
10. More?

B. Non-economists often insist, “This is a republic, not a democracy.” Strictly speaking, they’re right, even if unpopular restrictions on democracy tend to disappear.
1. Alternate formulation: “There are many different kinds of democracy.”

C. Whether or not you call them “democratic,” couldn’t many of these restrictions mitigate democracy’s political failures?

D. Ex: Supermajority rules (2/3 vote for price controls), limitations on the scope of democracy (“Congress shall pass no law infringing the freedom of production and trade”), and federalism could all mitigate anti-market bias.

E. Ex: Giving two votes to college grads could mitigate anti-foreign bias.

F. Ex: How about giving the CEA veto power over trade restrictions?

G. More examples?

III. Constitutional Reform and Endogenous Institutions

A. Direct democracy rarely prevails in a pure form. Constitutional restrictions are all around us.

B. These observations lead many people in public choice – most prominently, James Buchanan – to advocate constitutional reforms to improve upon the status quo.

C. Example: 2/3 rule for spending. Perhaps then, pork barrel projects will fail, and only genuine public goods will receive funding.

D. Problem: It seems like any public choice problem that afflicts day-to-day democracy will afflict constitutional choice as well.

E. In other words, constitutions are *endogenous institutions*. They are a product of the same forces that generate other social outcomes, and no easier to change.
1. French/U.S. switch thought experiment.

F. Some proposed constitutional amendments have no obvious impact on policy. These are relatively easy to pass, but what's the point?

G. Other proposed constitutional amendments would obviously affect policy. These are hard to pass because the policies that currently exist tend to be popular.

H. Note: This doesn’t mean that direct democracy always prevails, just that invoking “constitutional changes” as a solution to problems with the status quo is probably wishful thinking.

IV. Are Constitutional Politics Different?

A. Still, Buchanan and others insist that constitutional politics *are* different. Their central argument:

B. Constitutional politics operates behind a real (not merely hypothetical) "veil of ignorance." This leads people to *selfishly* favor socially efficient policies.

1. Buchanan's favorite example: Auto accident liability rules. At the constitutional level, no one knows whether he'll be a plaintiff or defendant, so we can get unanimous (or "virtually unanimous") support for efficient policies.

C. This whole argument rests on the discredited SIVH, but it fails even on its own terms. There may be *some* constitutional rules where a veil of ignorance applies (though even Buchanan's favorite example overlooks lawyers). But most constitutional rules are about *permanently locking in existing political advantages*.

D. Consider a few examples from the U.S. Constitution. Cui bono ex ante?

1. The purpose of the Senate is to permanently give small states disproportionate influence.
2. The purpose of the slave trade provision is to make sure that the slave trade remains legal until 1808.
3. The purpose of the three-fifths compromise is to reduce the total influence of the South, but increase the influence of Southern whites.

E. Or consider modern some Constitutional decisions. Cui bono ex ante?

1. The purpose of court rulings on religion is to prevent the religious majority from doing what it wants to the secular minority.
2. The purpose of court rulings on abortion is to prevent states with pro-life majorities from restricting abortion.
3. Others?

F. In each of these cases, it is obvious ex ante who will benefit and who will lose. The point is to reassure the winners of today that they will continue to get their way even if political conditions change to their disadvantage.

G. In "Before Public Choice," Buchanan freely admits that social contract theory is a "myth" designed to "rationalize" the status quo. Exactly.

H. Rebuttals?

V. Futarchy

A. The most original and thoughtful suggestion for constitutional change in decades, if not centuries: Robin Hanson's "futarchy."

B. Background: Empirically, prediction markets (a.k.a. betting markets) are the best way to estimate the future. They are the turbo-powered version of "Put up or shut up."

C. *Any* question that eventually has a verifiable answer can be turned into a financial instrument – and its market price will efficiently aggregate all available information.
D. This includes *contingent* instruments such as…
    1. A stock price conditional on firing the CEO.
    2. The unemployment rate conditional on Obama winning.
    3. Terrorism deaths conditional on invading Iraq.
    4. Tax rates in 2020 conditional on TARP.
E. Do betting markets give perverse incentives to make bad things happen? We rarely worry about this for traditional financial instruments, and in any case there is a simple solution: Register the bettors, and/or cap the bets.
    1. 9/11 Commission found no evidence that anyone used prior knowledge of the attacks to profit.
F. Do betting markets encourage manipulation to mislead people using the market price to make decisions? No. Manipulation just provokes arbitrage. See the Hanson-Oprea experiment.
G. Robin's innovation: A constitution could *require* decisions to be based on betting market prices.
H. Moderate example: A corporate charter could include a "fire the CEO" provision that says that if the value of the firms' stock conditional on firing the CEO ever exceeds its value conditional on retaining the CEO, the CEO gets fired.
I. Robin advocates turning this approach into the basis for a whole system of government. He calls it "futarchy." Slogan: "Vote on values, but bet on beliefs." This means that:
    1. The political process defines an objective function, such as "maximize GDP" or "maximize GDP plus the market value of leisure" or "maximize GDP per capita times life expectancy." As a short-hand, Robin calls the maximand GDP+.
    2. If betting markets say that a policy has a higher expected value of GDP+ than the status quo, the constitution *requires* the adoption of that policy.
J. Ex: Someone proposes TARP. Betting markets on GDP+|TARP and GDP+|~TARP go online. If and when the value of the former exceeds the latter, TARP gets adopted. Critics can then set up betting markets about the expected effect of abolishing TARP.
K. Most criticisms of futarchy argue that betting market odds are not to be trusted. These criticisms are weak, and often ignore extensive, specific counter-evidence and simple fixes.
    1. Will the marginal suicide bomber change his mind if he add $100 to his will?
L. My main concern is with the definition of GDP+. A key weakness of central planning was that managers were given maximands that sounded good at the time, but gave perverse incentives.
M. Thoughts?

Prof. Bryan Caplan
bcaplan@gmu.edu
http://www.bcaplan.com
Econ 854

Week 14: Anarchy

I. Economic Arguments for Government
   A. Econ textbooks have a standard list of economic arguments for government intervention:
      1. Monopoly
      2. Imperfect information
      3. Public goods/externalities
      4. High transaction costs
      5. The most recent addition: irrationality.
   B. From a comparative institutions perspective, these are unconvincing. After all, all of these "market failures" can and do afflict governments, too.
   C. Some would argue that these problems are actually *worse* for government. Consider:
      1. Monopoly: How about the two-party system?
      2. Imperfect information: How about voter ignorance?
      3. Public goods/externalities: How about sensible voting as a public good?
      4. High transactions costs: Look how hard it is to "buy out" teachers' unions, turnpike workers, and kleptocrats.
      5. Irrationality: Isn't voter irrationality vastly worse than consumer or producer irrationality?
   D. It is particularly hard to wean economists away from the public goods rationale for government. (In fact, it is a struggle to get economists to stop equating "government spending" with "spending on public goods"!)
   E. The source of its appeal: The intuition that, "Public goods problems don't solve themselves."

II. The Paradox of Public Good Provision
   A. Isn't monitoring the government to act in socially beneficial ways itself a public good?
   B. The Paradox: If citizens can voluntarily produce the public good of monitoring government, why can't they solve other public goods problems without government? If they can't voluntarily solve this problem, what reason is there to expect government to improve matters?
   C. Cowen and Kavka (2003) offer several solutions to this paradox:
      1. The tying hypothesis. This is very similar to the stationary bandit model: As long as leaders have a reasonably long time horizon, socially beneficial policies are a *private* good for government leaders.

2. Altruism and noise hypothesis. Governments can leverage a small initial altruistic donation. "The establishment of a government… may require a smaller number of acts of altruistic support than non-monopolistic mechanisms for producing public goods would require. Unlike a competitive firm, once a monopolistic government obtains a certain amount of initial support, it can use its monopoly power to induce continued support in the future."
3. Bootstrap hypothesis: Support for government is really a coordination game, not a Prisoners' Dilemma, because if most people support a state that provides public goods, it is selfishly optimal for you to do so as well.

D. From discussion with Tyler: Unless anarchy is better than government, government must *on net* produce public goods.

III. Are the Functions of the Night-Watchman State Really Public Goods?

A. OK, so what about anarchy?

B. If you remain dissatisfied with democracy, reject constitutional reform (even futarchy!) as a solution, and abhor dictatorship, anarchy is all that's left.

C. There is a surprisingly large economic literature on the possibility of "free-market anarchism" or "anarcho-capitalism," beginning in 1849 with Gustave de Molinari's article, "The Production of Security" in the *Journal des Economistes.* See Stringham's *Anarchy and the Law* for a broad survey.

D. Ferdinand Lasalle was not imagining things when he attacked, "Those modern barbarians who hate the state – not this or that state, not this or that state-form, but the state altogether. And who, as they now and again have clearly admitted, would most prefer to abolish the state, auction off justice and police to the cheapest suppliers, and have war run by joint-stock companies, so that there should nowhere in all of creation still be an ethical point from which resistance could be offered to their capital-armed mania for exploitation."

E. Our analytical procedure: Start with the functions of the night-watchman state (NWS) – dispute resolution, rule formation, and enforcement – and work backwards.

F. Specifically: What aspects, if any, of these functions are really public goods?

IV. Dispute Resolution as a Private Good

A. Two people have a contract dispute. The night-watchman state takes it upon itself to adjudicate. For disputes it labels "criminal," the NWS goes further by handling the prosecution.

B. Why? Where is the public good? Why couldn't the parties (or their insurers) simply put an arbitration clause in their contracts, which the night-watchman state enforces? And why does the NWS have to handle the prosecution itself?

C. Hard case for arbitration: complete strangers. Night-watchman state could still minimize its role by compelling defendant to choose from an approved set of arbitrators.
D. Hard case for private prosecution: indigent defendants.

V. Rule Formation as a Private Good
A. The NWS also takes it upon itself to pass civil and criminal laws.
B. Why? Where is the public good? Private arbitration firms could (and to some extent already do) ex ante woo customers by offering the most efficient set of rules.
1. Efficient rules give parties incentives to maximize joint wealth of signatories, factoring in expected cost of disputes.
C. Landes and Posner argue that lack of intellectual property rights in precedents leaves little incentive for rule formation.
D. In practice, though, public courts often defer to expert judgments of arbitrators. Intellectual property rights in rules could be strengthened, and non-patent incentives are often effective.

VI. Enforcement as a Private Good
A. The NWS also tries to monopolize enforcement.
B. Why? Where is the public good? Once an arbitrator makes a decision, why can't it be enforced by ostracism, bonding, or private security guards?
C. An unconventional solution to the problem of indigence and crime: indentured servitude and private prisons.
D. NWS could again mechanically defer to arbitrators' decisions.

VII. Moderate versus Radical Privatization
A. To a surprising extent, markets already share the supposedly exclusive turf of the NWS.
1. Private security
2. Arbitration
3. Arbitrators' codes of rules
4. Bonding
5. Credit ratings
6. Ostracism
B. It would be easy to drastically expand the role of the market in these areas, while leaving the state as the final authority. Let us call this *moderate* privatization.
C. But this is hardly an alternative to government, because the state remains – and decides how far the alternatives are allowed to go.
D. What about *radical* privatization - getting rid of the last remnants of the NWS state?
E. What would this even look like? Standard picture:
1. Individuals subscribe to services of a defense firm.
2. Defense firms arbitrate their disputes in private courts.
3. Private courts issue monetary judgments.
4. Reliable people unable to pay their debts have their earnings attached.

5. Others, especially criminals, become indentured servants and work off their debt in private prisons that bid for inmates.

VIII. Main Objections to Radical Privatization

A. Obviously, free-market anarchism is not a popular proposal. What are the main objections?

B. "Externalities of defense services."

1. Reply: These have more to do with current policy than the nature of the product. If police only help paying customers, if judges charge for adjudication, if victims who prosecute win restitution, where is the externality?

2. Turnaround: Government defense has lots of externalities. Bureaucrats who make the world safer get paid the same as those who don't. Oftentimes "crusaders" become very popular by causing the crime they claim to be fighting (e.g. Prohibition).

C. "It would lead to violent chaos."

1. Reply: Why? It is cheaper to negotiate than to fight, especially since police companies repeatedly interact with each other. Also, police company employees, unlike conscripts, have to be paid more for a riskier job.

2. Turnaround: Existence of government leads to wars, which are far more serious than police agency shoot-outs because governments control the resources of the whole society.

D. One strong agency would take over and become the new government." (Alternate version: Agencies would merge until they had a monopoly).

1. Reply: This would only be possible if there were a large MES relative to the demand for defense services. In the current U.S., there are already about 10,000 security guard companies, so there is little reason to fear the dominance of one strong agency.

2. Turnaround: A much bigger risk from governments, since their MES is much larger than for mere police agencies.

E. “Police agencies would build up demand by defending their clients to the death."

1. Reply: This would create a severe "adverse selection" problem, just like the one that insurance companies face. If you announce that you will protect your clients to the death, you encourage high-risk, lawless people to hire you, raising your costs enormously.

F. “People would have no incentive to prosecute crimes."

1. Reply: Monetary restitution provides the incentive; the ability to impose indentured servitude ensures that almost all convicted persons will be solvent.

2. Turnaround: This is true today: the only incentive of victims to cooperate with prosecutors is desire for revenge. E.g. rape victims are often better off staying quiet.

G. “Criminals would be over-punished."
1. Reply: In many ways, profit-making prisons would be more humane: there is an incentive to protect the safety of workers, to separate workers by size and strength, and to provide useful job training. Legal codes could incorporate prisoner protection as well.
2. Turnaround: Numerous non-violent offenders are currently sentenced to harsh prison conditions.

H. Others?

IX. Cowen, Anarchism, and Collusion

A. Tyler Cowen has a novel objection to free-market anarchism: Defense is a *network industry*. Collusion is relatively easy to orchestrate in such industries due to the threat of expulsion.
1. There might seem to be a lot of firms, but for practical purposes there will only be one.

B. In such industries, some forms of collusion (relating to product standardization) are actually beneficial; but this opens the door to the traditional forms of inefficient collusion (like price-fixing).

C. According to Cowen, this leaves basically two possible cases:
1. Case 1: Transactions costs are low enough to make collusion work. Then both the efficient and inefficient forms of collusion thrive. The public faces a profit-driven monopoly defense firm, a great example of Hobbes’ Leviathan.
2. Case 2: Transactions costs are too high to make collusion work. Then neither the efficient or the inefficient forms of collusion appear. The public faces chaos, a great example of Hobbes’ “state of nature.”

D. Stringham and I reply to Cowen in the *RAE*. Main argument: Cowen conflates coordination problems with prisoners’ dilemmas.

E. Product standardization is a coordination problem. Once firms expect certain standards to prevail, it pays to conform.

F. Price-fixing, extortion, etc. are prisoners’ dilemmas. If other firms are changing high prices and mistreating customers, it pays to stay honest and gain their business.

G. Historically, network industries do not seem to have been especially able to achieve collusive outcomes, but they have solved a lot of coordination problems:
1. After anti-trust: Credit cards
2. Before anti-trust: Clearinghouses

X. National Defense

A. What about national defense? Isn’t that clearly a public good?

B. Answer: It depends. "National defense" is not a public good for the *world* because if no country had "national defense," no country would need it!
C. Implication: Countries' "national defense" programs are often a public bad – and the losers typically include their own citizens.
D. Simplest reply to the national defense objection: Our country's national defense is a public bad, and both we and the rest of the world would be safer without it.
    1. This argument became far more convincing after the fall of the Soviet Union.
E. Still, how would a free-market anarchist society defend itself against invasion by an aggressive state? Surely *that* would be a public good.
F. Answers:
    1. Voluntary charity. Members of the anarchist society could volunteer both money and their labor to defend their society from attack.
    2. Ideology. A successful anarchist society would have many external sympathizers, making it difficult to rationalize aggression. Look at how little the capitalist world did to crush the Soviet Union in its infancy.
    3. If this seems naïve, consider a Tullockian challenge: "Give me one good reason not to invade Brazil."

XI. The Transition Problem
A. The biggest challenge to anarcho-capitalism: The transition problem. How do we get from here to there?
B. Most radical movements consider violent revolution. But even if this were feasible, what are the odds that violent revolution would create a *freer* society, much less a free society?
    1. David Friedman's quip: "Revolution *is* the hell of it."
C. From a libertarian point of view, most revolutions are a complete disaster. Even the American Revolution is greatly overrated by libertarians – government didn't really shrink, and the rights of slaves and Indians would have been better protected by the British.
    1. Question: Are revolutions a good example of the idea trap?
D. Other options are viable for marginal change, but offer little hope of radical change in the foreseeable future:
    1. Persuasion
    2. Infiltrating the political system to take advantage of slack
    3. Coordinated movement to change the median voter (e.g. the Free State Project)
E. What about just creating a new society?
    1. "Create your own country" projects end in failure or conquest by neighboring old country.
    2. Paul Romer's solution: Charter cities
    3. Patri Friedman's solution: Seasteading

F. My case against fatalism: Radical change is very difficult to achieve, but what sensible person ever thought otherwise? To quote Tollison, “We’re all part of the equilibrium.” You can still make a marginal difference – and do good while doing well.