

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

## **Week 11: Behavioral Political Economy**

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- 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.
- II. 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 SAE 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?
- III. 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.
- IV. 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 favorable 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.
- V. 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?

- VI. 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.
- VII. 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.
- VIII. 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?
- IX. 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.
- X. 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?
- XI. 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 a 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?