

not come up with a satisfactory alternative. The formulation of meaningful rules and constraints for the budgetary process, either at the constitutional or statutory level, is an important item on both the academic and political agendas for the years ahead.

It should be stressed that the judgment that currently government may be inequitable or inefficient does not necessarily imply that government as an institution is “bad.” People who like market-oriented approaches to resource allocation can nevertheless seek to improve markets. The same goes for government.

## SUMMARY

This chapter examines the problems of public choice in both direct and representative democracy.

### DIRECT DEMOCRACY

- Economists have studied several methods for choosing levels of public goods:
  - Lindahl pricing results in a unanimous decision to provide an efficient quantity of public goods, but relies on honest revelation of preferences.
  - Majority voting may lead to inconsistent decisions regarding public goods if some people’s preferences are not single peaked.
  - Logrolling allows voters to express the intensity of their preferences by trading votes. However, minority gains may come at the expense of greater general losses.
- Arrow’s Impossibility Theorem states that, in general, it is impossible to find a decision-making rule that simultaneously satisfies a number of apparently reasonable criteria. The implication is that democracies are inherently prone to inconsistency regarding public goods and other decisions.

### REPRESENTATIVE DEMOCRACY

- Explanations of government behaviour require studying the interaction of elected officials, public employees, and special interest groups.

- Under restrictive assumptions, the actions of elected officials mimic the wishes of the median voter.
- Public employees have an important impact on the development and implementation of economic policy. One theory predicts that bureaucrats attempt to maximize the size of their agencies’ budgets, resulting in oversupply of the service.
- Rent-seeking private citizens form groups to influence government activity. Special interests can form on the basis of income source, income size, industry, region, or personal characteristics.
- The growth of government has been rapid by any measure. Explanations of this phenomenon include:
  - Citizens simply want a larger government.
  - The public sector must expand to absorb private excess production.
  - Random events (such as wars) increase the growth of government, while inertia prevents a return to previous levels.
  - Unrealistic expectations have resulted in increasing demands that ignore the opportunity costs of public programs.
  - Certain groups in the population use the government to redistribute income to themselves.
- Proposals to control the growth in government include decentralization to reduce bureaucratic power and encouraging private sector competition.

## EXERCISES

1. Suppose there are five people—1, 2, 3, 4, and 5—who rank projects A, B, C, and D as follows:

	1	2	3	4	5
A	A	A	D	C	B
D	C	C	B	B	C
C	B	B	C	D	D
B	D	A	A	A	A

- a. Sketch the preferences, as in Figure 7.2.
- b. Will any project be chosen by a majority vote rule? If so, which one? If not, explain why.

2. Consider a society with three people (John, Eleanor, and Abigail) who use majority rule to decide how much money to spend on a public park. There are three options for spending: *H* (high), *M* (medium), and *L* (low). These individuals rank the three options in the following way:

Rank	John	Eleanor	Abigail
1	M	L	H
2	L	M	M
3	H	H	L

- a. Consider all possible pairwise elections: *M* versus *H*, *H* versus *L*, *L* versus *M*. What is the outcome of each election? Does it appear, in this case, that majority rule would lead to a stable outcome on spending on the public park? If so, what is the choice? Would giving one person the ability to set the agenda affect the outcome? Explain.
  - b. Now suppose that Eleanor's preference ordering changed to the following: first choice = *L*, second choice = *H*, and third choice = *M*. Would majority rule lead to a stable outcome? If so, what is the choice? Would giving one person the ability to control the agenda affect the outcome? Explain.
3. Return to Exercise 4 in Chapter 4, where Moe, Larry, and Curly are hiring the services of an acting coach. Suppose the coach's fee is \$15 per hour.
- a. If the trio share the hourly cost equally, and they use majority voting to determine the number of hours of coaching to hire, how many hours will they choose? Is this close to the efficient quantity?
  - b. Suppose that the cost of hiring the coach is divided in the following way: Moe and Curly each pay \$1 per hour, and Larry pays \$13 per hour. Show that in this case majority voting leads to excessive spending on the acting coach.
4. Three voters, A, B, and C, will decide by majority rule whether to pass bills on issues X and Y. Each of the two issues will be voted on separately. The change in net benefits (in dollars) that would result from the passage of each bill is as follows:

Voter	Issue	
	X	Y
A	+6	-3
B	-1	+4
C	-2	-3

- a. Which issues (if any) would pass if decided by majority rule? Is this the efficient outcome?
  - b. Which issues (if any) would pass if logrolling were allowed? Would logrolling improve efficiency? Would it result in the efficient outcome?
  - c. Suppose that it were legal for one voter to pay another voter to vote in a certain way. Would allowing such side payments improve efficiency in part b? Would it result in the efficient outcome?
  - d. What amount of side payments would take place if paying for votes were allowed?
5. Industries in the country of Technologia invest in new equipment that annually increases productivity of private workers by 3 percent. Government employees do not benefit from similar technical advances.
- a. If wages in the private sector are set equal to the value of the marginal product, how much will they rise yearly?
  - b. Government workers annually receive increases so that wages remain comparable to those in the private sector. What happens to the price of public services relative to privately produced goods?
  - c. If the same quantity of public services is produced each year, what happens to the size of the government (measured by spending)?
6. In 1998, the people of Puerto Rico held a referendum in which there were five choices: retain commonwealth status, become a state, become independent, adopt "free association" (a type of independence that would delegate certain powers to the United States), and "none of the above." Discuss the problems that can arise when people vote over five options.
7. In view of the attacks on September 11, 2001, fears exist that terrorists could attempt to sabotage a country's food supply. Security related to threats to Canada's food supply is under the jurisdiction of the Canadian Food Inspection Agency (CFIA). Use the Niskanen model of bureaucracy (Figure 7.5) to predict how new concerns over food safety would affect the optimal number of CFIA employees and the actual number of employees.
8. Why do you think firms lobby the government to enact policies that restrict production in their industry, rather than simply agreeing to restrict production on their own?