The Economics Of Politics

PENGUINS, crowded together for nesting on an island in the South Atlantic, often attempt to complete their nests by taking suitable pebbles from their neighbours. To an individual penguin, this is the obvious thing to do; there, close by, is a suitable pebble—so why search further? But to a watcher, the sight of hundreds of birds frantically indulging in this collectively self-defeating behaviour is unutterably comic. Why is it so funny? Probably because we have come to see something ludicrous about a group which has not made at least some progress in the art of living in a community; the art to which the ancient Greeks gave the name "politics."

The first thing that has to be said about the economics of politics is that economic progress would scarcely have been possible without the prior solution of the basic problems of politics. Indeed, the subject-matter of economics depends largely upon the notion of coöperation.

The benefits of cooperation are brought out dramatically by the old puzzle of "the prisoner's dilemma." Each of a pair of robbers is told that if they both confess, they will be imprisoned for 5 years; if neither confesses, the sentence will be 2 years; but if only one confesses, he will go free and the other will get 10 years. What should they do? Prisoner A would see his possible sentences as follows:

	If B confesses	If B does not confess
If A confesses	5 years	Freedom
If A does not confess	10 years	2 years

Whichever choice B reaches, A will be better off if he confesses. Prisoner B makes the same calculation. The result is that they both confess and they both get 5 years. Given trust and cooperation they need only have served 2 years. Similar situations can arise in real life. On an international scale, the choice between free trade and protection can sometimes pose a similar dilemma.

There are, as Sam Brittan has pointed out,[1] three ways in which people can be brought to cooperate for their mutual benefit. First they can be given orders—**the command system,** which remains a command system even if the orders are decided by majority vote. Secondly, they can do what is required out of **mutual benevolence.** Thirdly, they can cooperate because it is in their private interest to provide others with what they want—**the market system.**

The idea of cooperation arising from benevolence has a strong emotional appeal, but there are reasons for thinking it insufficient except in very simple circumstances. It does not provide the information needed to take sensible decisions. Cooperation motivated by altruism is perhaps most common in the family—made possible in this case by strong bonds of mutual trust and understanding.

BY JOHN GREEN

COMMAND systems are also likely to run into information difficulties. They can to varying degrees be so devised as to be responsive to the wishes of the populace, but they can hardly be expected, even in principle, to be sensitive enough to reflect the vast variety of needs, tastes and preferences of even quite a small population. Voting systems can be devised which are capable of making "yes/no" decisions to the satisfaction, at least of the majority, but they are not generally suitable for the "how much" decisions which have to be made in the sphere of economic activity. Even for "yes/no" decisions they have the drawback of being incapable of reflecting the strengths of people's preferences. Thus the mild preference of a slight majority might over-rule the bitter antipathy of the remaining minority.

The market system involves what—but for its familiarity—would be a striking paradox. Competition—which, after all, would seem to be the antithesis of cooperation—can, if it operates under suitable rules, be the motive force for an immensely powerful system of cooperation. The market system is, moreover, free from the drawbacks of the other two systems. It is capable of interpreting and acting upon the immense quantities of information in the form of prices and buying behaviour. It copes automatically with the problem of strengths of preference by responding to a willingness—by paying a price—to sacrifice other goods for the item in question. Its strength lies in the fact that, since the entire population takes part in the process of decision-making, it requires no 'outside' direction. It is, in Sam Brittan's phrase, "participation without politics." Politics in the sense of a command system is of course necessary to determine the rules—such as the prohibition of fraud and of misleading advertising—which are thought necessary for its effective operation. But a regulatory command system of this sort is a far cry from a system which decides what should be produced and for whom.

Whatever the merits of the market system, it cannot perform all of the cooperative functions which are required. The proper position of the dividing line between the market system and the command system—that is to say, the government—is an important subject for public debate.

The latest contribution to this debate is the recently-developed "economics of politics." This offers a challenge to the conventional assumption that those who operate the command system in democratic societies are motivated solely by the desire to serve the interests of those whom they have been elected to represent. Economic theory does not assume that the actions of businessmen are motivated by altruism, so why should it make that assumption about the actions of politicians and civil servants?

If, instead, of assuming that all politicians are motivated by altruism, they are assumed to be motivated by a desire to win votes, some new conclusions emerge concerning the operation of the command system. Prof. Tullock's *The Vote Motive*[2] provides a glimpse of some of the developing methodology. It shows, for example, that a well-informed two-party system tends to offer a narrow choice of policies close together in the middle ground of public opinion, but that three-party systems tend to offer a very much wider choice. He also demonstrates that if one party in a two-party system makes a mistake in its interpretation of public opinion, it will pay the other party to move part way in the same direction. Suppose, for example, that party A declares its policy to be to reduce the size of school classes to 15, but that it subsequently emerges that public opinion is equally divided as to whether class size should be above or below 24. What should party B do? If it were concerned solely with the public interest, it would promise class sizes of 24. But if it wanted to get the maximum number of votes it would do better if it promised a size slightly above A's—say 17. This is because B would get the votes of all those who want class sizes larger than a point half way between A's promise and B's promise. This theory may, perhaps, explain the otherwise puzzling behaviour of the last Labour Government over Common Market membership. Professor Tullock refers to, but does not develop, the theory that majority voting systems may be incapable of coming to a stable decision but tend instead to oscillate from one alternative to another.

When in office, politicians tend to adopt policies which differ from those on which they were elected. M. J. Stewart in his analysis of politics and economic policy since 1964[3] makes the startling observation that nearly every post-war government has adopted some form of incomes policy; usually after being elected on promises to eschew such policies. The behaviour of politicians when in office, and of their advisers, is therefore at least as important a subject as that of their behaviour when seeking election.

PERHAPS the most important task to be tackled by the economics of politics is to explain how we have been led into the present "stagflation" situation of persistent unemployment combined with persistent inflation. There is no such explanation to be found in text-books on economic management, possibly because of their universal assumption that economic policy would be operated by a government elite operating in the detached manner of Plato's philosopher-kings. The founder of current theories of economic management is known to have believed in the "Bloomsbury view" under which a wise elite would manipulate public opinion in such a way as to gain their acceptance of those measures which were necessary for the public good.

The role of the economist in Keynes' scheme of things would be that of a "dentist," a technician working skilfully to repair the malfunctioning of the economy. But the writings of those—such as Sir Alec Cairncross,[4] Professor Alan Peacock[5] and Ralph Turvey[6]—who have observed the formation of economic policy at first hand demonstrate how wide of the mark were Keynes' hopes of how it would work out. "The role of the economist as the impartial, cautious technical observer always appealing to the evidence cuts little ice with politicians and administrators thirsting for action . . . . policies will be instituted despite the warnings of the economist . . . ."[5] Keynes had hoped that with the help of impartial advice, governments would remedy depressions with budget deficits and inflation with budget surpluses. In practice, only the first half of this prescription has been applied. As a recent Hobart Paper[7] has pointed out, the British fiscal constitution has acquired a strong bias toward deficit finance.

Keynes is said to have responded to those who pointed to the possibility that his proposals might be harmful in the long run with the retort that "in the long run we are all dead!" In the context of the economics of politics this may have been one of the most significant of his sayings. If economists had advised upon the consequences of current

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NOW FOR PROPOSITION 14!

BOB CLANCY writes from NEW YORK

PROPOSITION 13 was scarcely a simple matter, being hedged in with qualifications, and upon analysis is seen to benefit the big property holder more than the small homeowner. Already the benefit of the lower tax has been reflected in increased rents.

Mr. Jarvis has stated that "property is sacred"—he has been an agent for real estate interests—and he would like to see taxes levied on other sources than property. An ancient voice speaks here: it was the landlords of England who, in 1689, in the name of liberty, shifted their burden of taxation onto the general populace.

It is fitting that there should be a taxpayer's revolt, but it would be better directed against other taxes which have far less merit and do much more harm than the property tax. The property tax is direct and visible. It is generally levied at the local level. It goes to pay for local services. It is controlled more directly by the taxpayer than other taxes. And it has to be accounted for in terms of how much is levied and how it is spent. What other taxes have that much going for it?

The lion's share of taxation is taken by the federal income tax along with the social security tax. The average property owner pays more income tax than property tax. The taxpayer is very remote from controlling the income tax and usually knows about changes (mostly upward) only when it is deducted from his pay. It then disappears into the maze of federal bureaucracy, and any semblance of control over how it is spent is even further removed from the taxpayer—unless he is part of one of the powerful lobbies in Washington demanding special favours! Unlike with the property tax, the taxpayer would be hard put to say what services he is getting for the income tax he pays. There are also state income taxes which are hardly more accountable or uncontrollable.

As for the hundred and one other taxes, the taxpayer hardly knows they are there. It has been estimated that there are 150 taxes hidden away in a loaf of bread. One could count an equally impressive number in all the other things people buy—food, furniture, clothing, automobiles, plus hefty tariffs on imports, taxes on travel, general purchases, licenses, interest on bank deposits, dividends on stocks, and so on. ...

Of course the trouble with all this is that one would not know where to begin a revolt against these really harmful taxes, whereas the property tax is a highly visible target; furthermore, big propertied interests can afford to go after it and hide behind the poor harried homeowner.

Unfortunately these are not the issues around which the property tax is being debated. The opponents of Proposition 13 are indeed accepting it as a taxpayer's revolt and are merely warning about the dangers in cutbacks in government services. In California, warnings are being sounded about what will happen after the state's surplus is used up, in about a year. What is likely to happen is that it will be found that the unsolved problems of the economy will demand public spending and then there will be an increase in indirect taxes or income tax.

What is needed it a real tax reform, not a crippling of the property tax. It needs to be noted that the property tax as now levied is not one but two taxes—a tax on land and a tax on improvements. It is right to revolt against the tax on improvements, which goes up the more productive one is. But the tax on land should be strengthened so as to be in proportion to its value, to discourage holding valuable land idle, to prevent monopolists and speculators from battening on the unearned income. Along with this there ought to be a revolt against taxes on our earnings and against the innumerable indirect taxes that plague us.

After disenchantment sets in about the workings of Proposition 13, will we be ready for Proposition 14?

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policy actions ten years hence, very little heed would have been paid them by any politician anticipating an election in three years' time. Economic management has in fact been based mainly upon forecasts which looked forward for no more than two years. The dangers of this procedure are brought out clearly in a recent report[8] which (referring, as it happens, to the crisis following the 1973 oil price rise) observed cautiously that "although the instinctive reaction in the short run is to attempt to soften the blow of such a crisis, it might not have been the best policy if it had the effect of inhibiting the inbuilt corrective mechanism in the economy." The suspicion is growing that many of the difficulties which we now face may be the delayed consequences of supposedly short-term measures taken many years ago.

The main problem raised by the economics of politics is how to devise a system in which the command system and the market system can work together for the public good. Some command systems—such as systems of commercial law—are of course necessary to the smooth operation of the market system, but other command systems may weaken the market system—sometimes in unexpected ways. Most Keynesian economists, for example, have seen themselves as helping to preserve the market system in good working order, but they may have been the unwilling agents in the process of weakening it. It may be that command systems have an inherent tendency to expand their activities at the expense of the market system. Worst of all, it may be that our present command system tends in the long run to be just as collectively self-defeating as the behaviour of the South Atlantic penguins. Perhaps a Martian observer would find our attempts to master the art of living together just as ludicrous?

1. *Participation without Politics*, Samuel Brittan, IEA, 1975.
2. *The Vote Motive*, Gordon Tullock, IEA, 1976.
3. *The Jekyll and Hyde Years*, M. J. Stewart, 1977.
4. *The Managed Economy*, Sir Alec Cairncross (Ed), Blackwell, 1970.
5. *Giving Economic Advice in Difficult Times*, Alan Peacock, Three Banks Review, March 1977.
6. *The Economist in the Public Service*, Ralph Turvey, Kemp Rybzynski (Eds), *The Economist in Business*, Blackwell, 1967.
7. *The Consequences of Mr. Keynes*, J. M. Buchanan, J. Burton and R. E. Wagner, IEA, 1978.
8. *Report of the Committee on Policy Optimisation*, Chairman: Prof. R. J. Ball, Cmnd. 7148, HMSO, 1978.