IEA

The Economics of POLITICS

How far do individuals agree/differ on 'public' goods?

Keynes and benevolent despots

Can majority voting represent the 'public interest'?

Are civil servants 'economic eunuchs'?

Can constitutions control government?

JAMES M. BUCHANAN

CHARLES K. ROWLEY · ALBERT BRETON

JACK WISEMAN · BRUNO FREY

A. T. PEACOCK

RT. HON. JO GRIMOND

Nevil Johnson · Ken Judge · Henri Lepage

Robert Grant · Paul Whiteley

W. A. NISKANEN · MARTIN RICKETTS

IEA Readings 18

INSTITUTE OF ECONOMIC AFFAIRS

The Institute was formed in 1957 as a research and educational trust that specialises in the study of markets and pricing systems as technical devices for registering preferences and apportioning resources. Micro-economic analysis forms the kernel of economics and is relevant and illuminating in both public and private sectors and in collectivist and individualist societies. Where the macro-economic method is used its results are verified and interpreted in the light of micro-economic significance.

The Institute's work is assisted by an advisory council which includes:

The Inst … Managing Trustees. I … nanced by sales of its … ndividuals, organisatic …

Inqui…

[*continued from back cover*]

11. Downs found a tendency of parties to establish positions near each other in two-party competition and near the centre of the ideological spectrum.

12. The mythology of the faceless bureaucrat following orders from above, executing but not making policy, and motivated only to forward the 'public interest', was not able to survive Tullock's logical onslaught. Bureaucrats could no longer be conceived of as 'economic eunuchs'. They will seek to expand the size of their bureaus since, almost universally in modern Western societies, the salaries and perquisites of office are related directly to the sizes of budgets administered and controlled.

13. Niskanen concluded that taxpayers end up by being no better off than they would be without any public goods; all of their net benefits are 'squeezed out' by the bureaucrats.

14. Stigler found evidence that regulation is pursued in the interests of the industries regulated.

15. Crain and Tollison developed evidence that politicians respond to economic incentives much like the rest of us.

16. The American constitutional structure is in disarray; the constraints that 'worked' for two centuries seem to have failed. The checks on government expansion no longer seem to exist. The Leviathan-state is the reality of our time.

17. Economists have blindly ignored the asymmetry in the application of Keynesian policy that the most elementary public choice theorist would have spotted. They naïvely presumed that the politicians would create budget surpluses as willingly as they create deficits. They forgot the elementary rule that politicians enjoy spending and do not like to tax.

18. Governments can be constrained. We refuse to accept the Hobbesian scenario in which there are no means to bridle the passions of the sovereign. Historical evidence from America's two centuries suggests that governments can be controlled by constitutions.

19. People should be treated as rational utility-maximisers in *all* their behaviour. This central insight leads to the conclusion that institutions must be designed so that individual behaviour will further the interests of the group, small or large, local or national.

20. The economic theory of politics represents a rediscovery and elaboration of a part of the conventional wisdom of the 18th and 19th centuries, notably that which informed classical political economy.

Extracts from

The Economics of POLITICS

J. M. Buchanan:

1. Britain held on longer than most countries to the romantic notion that government seeks only to do good . . . and to the hypothesis that government could accomplish most of what it set out to do. Lord Keynes, along with his American counterparts, continued to proffer policy advice as if talking to a benevolent despot who stood at his beck and call.
2. The political scientists were even more naïve than the economists, and they have not, even today, learned very much.
3. Individuals embody sets of preferences, which can hardly be identical.
4. Duncan Black, the British founding father, began by analysing the machinery of ordinary committees used to govern collective activities.
5. There may exist no motion or proposal (or candidate) that will defeat all others in one-against-one majority tests. The collective outcome will depend on where the voting stops, which in turn will depend on the manipulation of the agenda and the rules of order.
6. Arrow found that no 'social welfare function' could be constructed: the task was a logical impossibility.
7. In this setting, majority voting does produce a definitive result, and it satisfies voters in the middle more than voters at either extreme.
8. Public finance theory cannot be wholly divorced from a theory of politics.
9. Tullock found that a sequence of majority votes on spending projects financed out of general tax revenues can over-extend the budget and make everyone worse off than with no collective action.
10. America's political history has been 'superior' to that of Britain, which neither in theory nor in practice has imposed constraints on the exercise of parliamentary or legislative majorities comparable to those in America.

[*continued on inside back cover*]

ISBN 0-255 36114-9

£3.00

IEA **THE INSTITUTE OF ECONOMIC AFFAIRS**

2 Lord North Street, Westminster, London SW1P 3LB

The Economi
POLITICS

The Economics of POLITICS

How far do individuals agree/differ on 'public' goods?
Keynes and benevolent despots
Can majority voting represent the 'public interest'?
Are civil servants 'economic eunuchs'?
Can constitutions control government?

JAMES M. BUCHANAN

CHARLES K. ROWLEY ☐ ALBERT BRETON
JACK WISEMAN ☐ BRUNO FREY
A. T. PEACOCK

RT. HON. JO GRIMOND

Nevil Johnson · Ken Judge · Henri Lepage
Robert Grant · Paul Whiteley

W. A. NISKANEN · MARTIN RICKETTS

Published by
The Institute of Economic Affairs
1978

First published in November 1978 by
THE INSTITUTE OF ECONOMIC AFFAIRS

ISSN 0305-814X
ISBN 0-255 36114-9

Printed in England by
Goron Pro-Print Co. Ltd., Lancing, West Sussex
Set in Monotype Times Roman 11 on 12 point

Contents

Preface

The *IEA Readings* have been devised to refine the market in economic thinking by presenting varying approaches to a single theme in one volume. They are intended primarily for teachers and students of economics but are edited to help non-economists in industry and government who want to know what light economics can shed on the activities with which they are concerned.

Several *Readings* have been based on Seminars. Hitherto the audiences have comprised mostly non-economists in industry, government, the media who have heard papers by economic specialists in the subject. The economic theory of 'public choice', the machinery by which people with widely differing preferences make decisions on the production and distribution of goods and services they share jointly—government, bureaucracy, politics, democracy—originated and has been largely developed in the USA. It has in recent years been spreading to other countries. To present its main elements, the Seminar was arranged primarily for university and other teachers of economics and other social sciences. The list of 109 participants (pp. 183-185) includes academics (in several faculties) and non-academic people in government, industry and the media, especially interested in the subject. The Institute was fortunate in being able to persuade one of the Founding Fathers of the new theory, Professor J. M. Buchanan, who has been an adviser of the Institute since 1967, to deliver the opening lecture in order to indicate the origins and developments of the theory and to act as the keynote address for the Seminar. His lecture was heard by an audience of about 200 which included laymen interested in the general principles rather than in the detailed analyses and applications discussed in the Seminar.

Professor Buchanan's lecture is a masterly conspectus of the historical evolution of the new theory of public choice or 'economics of politics'. He performed the difficult task of compressing into some 5,500 words a rapidly growing school of economic thinking. Even where he used shorthand technical language the main elements were clear. For the convenience of readers they are put into 20 propositions on the back and inside back covers.

At the Seminar itself elements of the economics of politics were expounded and developed by five economists who have made themselves authorities in the subject: two from overseas, Professor Albert Breton of Canada and Professor Bruno Frey of Switzerland, and Professors C. K. Rowley, A. T. Peacock and Jack Wiseman of Britain.

Their papers showed new insights into the working of government and its instrument, bureaucracy, of the politics of government and of representative democracy in general. It would seem that in some respects they are able to explain the working of political democracy with more illumination than the political scientists have done.

To indicate how far the new theory of politics has been found illuminating in other social sciences the panel assembled five shorter discussions, by Professor Nevil Johnson, an authority on political institutions, Mr Ken Judge, an unorthodox thinker in social administration, M Henri Lepage, who reviewed developments in France, Mr Robert Grant, a specialist in business, and Mr Paul Whiteley, who teaches politics.

The *Readings* also contains two additional essays. The first is by W. A. Niskanen, formerly Professor of Economics at the University of California at Berkeley, who was unable to attend the Seminar. He has contributed the text of a lecture on bureaucracy in government and business, delivered to the American Association for the Advancement of Science. The second essay, by Martin Ricketts of the University College at Buckingham, on the thinking of Adam Smith relevant to the subject, was awarded the first prize in the 1976 IEA Adam Smith essay competition.

Important aspects of the subject were also raised in the Question and Discussion sessions following each paper, notably by Professor Stanislav Andreski, who teaches sociology at the University of Reading, Professor Mark Blaug of the University of London, Mr John Burton of Kingston Polytechnic, Mr Douglas Eden who teaches history and politics at Middlesex Polytechnic, Mr Christopher Goodrich, then a Ph.D. student at the London School of Economics, Mr Roy Houghton, senior lecturer in economics at the University of Sheffield, Professor George Jones, a specialist in government at the London School of Economics, Professor Stephen C. Littlechild of the University of Birmingham, Professor Brian Loasby of the University of Stirling, Professor J. E. Meade, Professor David Myddelton of the Cranfield Institute of Technology, Dr Morris Perlman of the London School of Economics, Mr Ian Senior of the Economists

Advisory Group, and Professor Tom Wilson of the University of Glasgow.

The literature on the new economics of politics or public choice (sometimes also referred to as 'the new political economy') is in Britain so sparse, specialist, or inaccessible in the technical journals that this *Readings* should be seen as a uniquely authoritative review of the subject for academics who are stimulated by and wish to teach it, for people in the activities of government and politics which it analyses, and not least for the general public which benefits or suffers from the activities of government. It should thus form an ideal text for teaching and for study by lay readers.

The Institute is grateful to the six main lecturers, to the five panellists, and to the Rt Hon Jo Grimond who opened the Seminar with informed observations on the new theory as seen by the practising public man. It also wishes to thank Lord Robbins and Professor Max Hartwell who chaired the morning and afternoon sessions for the liberal discipline they exercised over the proceedings.

September 1978 ARTHUR SELDON

PART I

From Private Preferences to Public Philosophy: The Development of Public Choice*

JAMES M. BUCHANAN
Virginia Polytechnic Institute and State University

* Basic reference works in public choice are listed at the end of the paper. A more sophisticated survey of the discipline is in Dennis C. Mueller, 'Public Choice: A Survey', *Journal of Economic Literature*, Vol. 14, No. 2 (June 1976), pp. 395-433. This survey paper is followed by Mueller's longer monograph, *Public Choice*, which should be published in early 1979. My survey paper, 'Public Finance and Public Choice', *National Tax Journal*, December 1975, relates developments in public choice to public finance. An elementary treatment of the various topics in public choice theory will be found in Gordon Tullock, *The Vote Motive*, Hobart Paperback 9, IEA, 1976.

The Author

JAMES M. BUCHANAN: Professor of Economics and Director of the Center for Study of Public Choice at the Virginia Polytechnic Institute, Blacksburg, Virginia, since 1969. Formerly Professor of Economics at Florida State University, 1951-56; University of Virginia (and Director of the Thomas Jefferson Center for Political Economy), 1956-68; University of California at Los Angeles, 1968-69. He is the author of numerous works on aspects of the economics of politics and public choice, including *The Calculus of Consent* (with Gordon Tullock), 1962; *Public Finance in Democratic Process*, 1967; *Demand and Supply of Public Goods*, 1968; *Public Principles of Public Debt*, 1958; *The Limits of Liberty: Between Anarchy and Leviathan*, 1975; and (with Richard E. Wagner) *Democracy in Deficit: The Political Legacy of Lord Keynes*, 1977. Professor Buchanan is a member of the IEA's Advisory Council. The IEA has published his *The Inconsistencies of the National Health Service*, Occasional Paper 7, 1965; and (with Richard E. Wagner and John Burton) *The Consequences of Mr Keynes*, Hobart Paper 78, 1978.

JAMES M. BUCHANAN:

I. INTRODUCTION

I appreciate the opportunity afforded me by this invitation from the Institute of Economic Affairs to come to London and to open this seminar on the 'Economics of Politics', or, as we prefer to call it, 'Public Choice', which is really the application and extension of economic theory to the realm of political or governmental choices. I shall be talking here about material that is familiar to many of you, but it remains nonetheless true that 'public choice' has been somewhat slower to attract attention in the United Kingdom than elsewhere in Europe. This body of ideas has been relatively neglected here, despite the presence of one of the genuinely seminal scholars in the discipline, Duncan Black, who has been, in one sense, a prophet without honour in his own country, or at least without appropriate honour.

I shall return to the position of 'public choice' in the UK, but first let me say that the sub-discipline is currently thriving, not only in America, but in West Germany, in Switzerland, in Japan, and, most recently, in France, where Henri Lepage has recently published a laudatory descriptive essay in *Réalités* (November 1977), an expanded version of which has now appeared as a chapter in Lepage's fascinating book *Demain le capitalisme* (1978).

History of neglect of 'public choice' in UK

The relative neglect of 'public choice' in the UK is traceable to factors that extend back for two centuries. To the classical economists, the state was unproductive. As a result of this common presupposition, less attention was paid to the analysis of state activity. Britain was also the origin of Benthamite utilitarianism, which provided idealised objectives for governmental policy to the neglect of institutional structure. Britain was also the home of idealist political philosophy in the late 19th century, a philosophy that put up barriers against any realistic examination of politics. Finally, the very dominance of Britain in the theory of the private economy, through the major influence of Alfred Marshall, drew intellectual resources away from the theory of the public economy. British and American analysis in public finance was a half-century out of date by the onset of World War II; the seminal contributions of the Continental scholars at the turn of the century and before were largely ignored, notably those of the outstanding Swedish economist, Knut Wicksell.

In Britain, you surely held on longer than most people to the romantic notion that government seeks only to do good in some hazily defined Benthamite sense, and, furthermore, to the hypothesis that government could, in fact, accomplish most of what it set out to do.

Your economists, and notably Lord Keynes, along with their American counterparts, continued to proffer policy advice as if they were talking to a benevolent despot who stood at their beck and call.[1] This despite Wicksell's clear but simple warning in 1896 that economic policy is made by politicians who are participants in a legislative process, and that economists could not ignore these elementary facts. But British and American economists throughout most of this century continued to seem blind to what now appears so simple to us, that benevolent despots do not exist and that governmental policy emerges from a highly complex and intricate institutional structure peopled by ordinary men and women, very little different from the rest of us. The political scientists were, if anything, even more naïve than the economists, and they have not, even today, learned very much.

II. THE ECONOMIC THEORY OF POLITICS

Why do we call our sub-discipline the 'economic' theory of politics? What is there that is peculiarly 'economic' about it? Here I think we can look to Duncan Black to put us on the right track. Black commenced his work by stating, very simply, that for his analysis an individual is nothing more than a set of preferences, a utility function, as we call it. Once this apparently innocent definition of an individual is accepted, you are really trapped. If you are to argue that individuals have *similar* preferences, you are forced into a position where you must explain why. And if you can think of no good reason why

[1] For a discussion of the political setting for Keynesian economics, see J. M. Buchanan, John Burton and R. E. Wagner, *The Consequences of Mr Keynes*, Hobart Paper 78, IEA, April 1978. An extended treatment with primary application to an American setting is in James M. Buchanan and Richard E. Wagner, *Democracy in Deficit*, Academic Press, New York, 1977.

they should do so, you are required to acknowledge that preferences may *differ* among persons.

From these innocent beginnings, the economic theory of politics emerges as a matter of course. The theory is 'economic' in the sense that, like traditional economic theory, the building blocks are *individuals*, not corporate entities, not societies, not communities, not states. The building blocks are living, choosing, economising persons. If these persons are allowed to have *differing* preferences, and if we so much as acknowledge that some aspects of life are inherently collective or social rather than purely private, the central problem for public choice jumps at you full blown. How are differing individual preferences to be reconciled in reaching results that must, by definition, be shared jointly by all members of the community? The positive question is: How *are* the differences reconciled under the political institutions we observe? This question is accompanied by the normative one: How *should* the differences among individuals in desired results be reconciled?

Even at this most elementary level, we must examine the purpose of the collectivity. I have often contrasted the 'economic' approach to politics with what I have called the 'truth judgement' approach. Individuals may differ on their judgements as to what is 'true' and what is not, and it is possible that, occasionally, we may want to introduce institutions that essentially collect or poll the opinions of several persons in arriving at some best estimate of what is 'true' or 'right'. The jury comes to mind as the best example here. The accused is either guilty or not guilty, and we use the jury to determine which of these judgements is 'true'. But for matters of ordinary politics, the question is *not* one of truth or falsity of the alternatives. The problem is one of resolving individual differences of preferences into results, which it is misleading to call true or false.

We can return to the parallel with standard economic theory. A result emerges from a process of exchange, of compromise, of mutual adjustment among several persons, each of whom has private preferences over the alternatives. Further, the satisfaction of these private preferences offers the *raison d'être* for collective action in the first place. The membership of a congregation decides, somehow, that the church-house is to be painted blue rather than green, but it is inappropriate to talk of either colour as being 'true'. The members of a school board decide to hire Mrs Jones rather Mr Brown, but we can scarcely say that the successful candidate embodies 'truth'.

The paradox of voting

Let me return to Duncan Black's seminal efforts, as he faced up to the central problem. I am sure that the natural starting place for Black was with ordinary committees that are used to govern many kinds of collective activities. In this, Black was probably influenced by his own participation in the machinery used for making university-college decisions, much as Lewis Carroll had been influenced by his own share in the committee governance of Christ Church, Oxford. And it is through Duncan Black that we know that the UK's claim to early ideas in voting theory rest largely with Lewis Carroll, who joins the French nobleman, Condorcet, in making up the two most important figures in the 'history of doctrine' before the middle years of this century.

How do committees reach decisions when agreement among all members is not possible? Simple observation suggested the relevance of analysing simple majority voting in formal terms. When he carried out this analysis Black was, I think, somewhat disappointed, even if not surprised, to find that there may exist no motion or proposal (or candidate) from among a fixed set of possibilities that will defeat all others in a series of one-against-one majority tests. There may exist no majority motion. If this is the case, simple majority voting will produce continuous cycling or rotation among a subgroup or subset of the available alternatives. The collective outcome will depend on where the voting stops, which will, in turn, depend on the manipulation of the agenda as well as upon the rules of order. The committee member who can ensure that his preferred amendment or motion is voted upon just before adjournment often wins the strategic game that majority rules always introduce. (It is interesting, even today, to observe the reactions of fellow committee members when a public-choice economist observes that the outcome of deliberation may well be dependent on the voting rules adopted.) The 'paradox of voting' became one of the staple ingredients in any subsequent public-choice discourse.

Arrow's 'paradox of social (collective) choice'

Only a short time after Black's early efforts, Kenneth Arrow (Nobel Laureate in Economics, now of Harvard University) confronted a somewhat different and more general problem, although he was to reach the same conclusion. Arrow tried to construct what some economists call a 'social welfare function' designed to be useful in guiding the planning authority for a society. He sought to do so by amalgamating information about the separate preferences of individual members, and he was willing to assume that the individuals' preferences exhibit the standard properties required for persons to make ordinary market choices. To his surprise, Arrow found that no such 'social welfare function' could be constructed; the task was a logical impossibility, given the satisfaction of certain plausible side-conditions. The paradox of voting became the more general and more serious paradox of social or collective choice.

Perhaps it is unfair to both, but I think that Duncan Black would have been happier if he could have discovered that majority voting rules do produce consistent outcomes, and that Kenneth Arrow would have been happier if he could have been able to demonstrate that a social welfare function could be constructed. Black was, and to my knowledge remains, dedicated to government by majority rule; Arrow was, and to my knowledge remains, an advocate of social planning. Black started immediately to look for the set of conditions that preferences must meet in order for majority voting to exhibit consistency. He came up with his notion of 'single-peakedness', which means that if all individual preferences among alternatives can be arrayed along a single dimension so that there is a single peak for each voter, there will exist a unique majority motion or proposal (or candidate). This alternative will be that one of the available set of proposals that is most preferred by the median voter. In this setting, majority voting does produce a definitive result, and in so doing it satisfies voters in the middle more than voters at either extreme. For example, if voters on school budgets can be divided roughly into three groups of comparable size—big spenders, medium spenders, and low spenders—the medium spenders will be controlling under ordinary majority voting, provided that neither the low nor the high spenders rank medium spending lowest among the three budget options. The formal collective or social choice theorists, shocked by the Arrow impossibility theorem, have continued to try to examine the restrictions on individual preferences that might be required to generate consistent social orderings.

III. THE THEORY OF CONSTITUTIONS

It is at this point in my summary narrative that I should introduce my own origins of interest in public choice, and my own contributions, along with those of my colleague, Gordon Tullock. As did Duncan Black, I came to public choice out of intellectual frustration with orthodox pre-World War II public finance theory, at least as I learned it in the English language works of such economists as A. C. Pigou and Hugh Dalton in the UK, and Harold Groves and Henry Simons in the US. It made no sense to me to analyse taxes and public outlays independently of some consideration of the political process through which decisions on these two sides of the fiscal account were made. *Public finance theory could not be wholly divorced from a theory of politics.*

In coming to this basic criticism of the orthodoxy, I was greatly influenced by Wicksell on the one hand and by some of the Italian theorists on the other. One of my first published papers,[2] in 1949, was basically a plea for a better methodology. My initial reaction to Arrow's impossibility theorem was one of unsurprise. Since political outcomes emerge from a process in which many persons participate rather than from some mysterious group mind, why should anyone have ever expected 'social welfare functions' to be internally consistent? Indeed, as I argued in my 1954 paper on Arrow,[3] it seemed to me that, if individual preferences are such as to generate a cycle, then such a cycle, or such inconsistency, is to be preferred to consistency, since the latter would amount to the imposition of the will of some members of the group on others.

'Positive public choice'

The next stage in my logical sequence came when Gordon Tullock and I started to analyse how majority rules actually work—what Dennis Mueller has called 'positive public choice'. Tullock developed his now-classic 1959 paper on majority voting and log-rolling in which he showed that a sequence of majority votes on spending projects financed out of general tax revenues could over-extend the budget and could, indeed, make everyone worse off than they would

[2] This paper, along with several other early papers, including my essay on the Italian writers, is reprinted in my book, *Fiscal Theory and Political Economy,* University of North Carolina Press, Chapel Hill, 1960.

[3] Also included in the book cited *ibid.*

be with no collective action.[4] Tullock's example was spending on many separate road projects all of which are financed from the proceeds of a general tax, but the same logic can be extended to any situation where there are several spending constituencies that independently influence budgetary patterns. We came to the view that the apparent ideological dominance of majority rule should be more thoroughly examined. This in turn required us to analyse alternatives to majority rule, and to begin to construct an 'economic theory of political constitutions', out of which came *The Calculus of Consent* in 1962. This book has achieved a measure of success, of course to our great satisfaction. We used ordinary economic assumptions about the utility-maximising behaviour of individuals, and we sought to explain why specific rules for making collective decisions might emerge from the constitutional level of deliberation.

To pull off this explanation, we needed some means or device that would enable us to pass from individually identifiable self-interest to something that might take the place of 'public interest'. Unless we could locate such a device or construct, we would have remained in the zero-sum model of politics, where any gains must be matched by losses. We got over this problem by looking at how rules for ordinary parlour games are settled *before* the fall of the cards is known. Uncertainty about just where one's own interest will lie in a sequence of plays or rounds of play will lead a rational person, from his own interest, to prefer rules or arrangements or constitutions that will seem to be 'fair', no matter what final positions he might occupy. You will, of course, recognise the affinity between this approach that Tullock and I used in *The Calculus of Consent* and that developed in much more general terms by John Rawls in his monumental treatise, *A Theory of Justice* (1971). Rawls had discussed his central notion of 'justice as fairness' in several papers published in the 1950s, and, while our approach came, we think, independently out of our own initial attempt to look for criteria for preferred rules, we do not quibble about the source of ideas. Indeed, the basic ideas in the 'justice as fairness' notion can also be found in the work of other scholars that predate Rawls's early papers.

Our book was a mixture of positive analysis of alternative decision rules and a normative defence of certain American political institu-

---

[4] Gordon Tullock, 'Problems of Majority Voting', *Journal of Political Economy*, Vol. 67, December 1959, pp. 571-79.

tions that owe their origins to the Founding Fathers, and to James Madison in particular. We considered that our analysis did 'explain' features of the American political heritage that orthodox political science seemed unable to do. Explicitly and deliberately, we defended constitutional limits on majority voting. In a somewhat more fundamental sense, we defended the existence of constitutional constraints *per se*; we justified bounds on the exercise of majoritarian democracy. In this respect, I would argue that America's political history has been 'superior' to that of Britain, where neither in theory nor in practice have you imposed constraints on the exercise of parliamentary or legislative majorities comparable to those in America. For example, it would be difficult to conceive of an American cycle of nationalisation, denationalisation, and renationalisation of a basic industry merely upon shifts in the legislative majority between parties.

IV. THE SUPPLY OF PUBLIC GOODS

I now want to get some of the early public choice contributions into methodological perspective. Black's early work on committees, Arrow's search for a social welfare function, our own work on the economic theory of constitutions, the derivations of these works in such applications as median voter models—all of these efforts were what we should now call *demand*-driven. By this I mean that the focus of attention was on the ways in which individual preferences might be amalgamated to generate collective results on the presumption that the outcomes would be there for the taking. There was almost no attention paid in these works to the utility-maximising behaviour of those who might be called on to *supply* the public goods and services demanded by the taxpayers-voters. There was no theory of public goods supply in the early models of public choice that I have discussed to this point.

Origins of public goods supply analysis

To get at the origins of the supply-side models, we must go back to some of the Italian scholars, who quite explicitly developed models of the workings of the state-as-monopoly, analysed as being separate and apart from the citizenry, and with its own distinct interests. Machiavelli is, of course, the classic source of ideas here, but the discussions of Vilfredo Pareto and Gaetano Mosca about ruling classes, along with the fiscal applications by the public-finance theorists such as Antonio De Viti De Marco, Amilcare Puviani, and Mauro Fasiani all deserve mention in any catalogue.

From these writers, and independently of them, we may trace the development of rudimentary ideas through Joseph Schumpeter and then to Anthony Downs, who, in his 1957 book, *An Economic Theory of Democracy*, analysed political parties as analogous to profit-maximising firms. Parties, said Downs, set out to maximise votes, and he tried to explain aspects of observed political reality in terms of his vote-maximising models. Perhaps the most important theorem to emerge here was the tendency of parties to establish positions near each other in two-party competition and near the centre of the ideological or issue spectrum. William Riker (of the University of Rochester), in a significant 1962 book, challenged Downs's vote-maximising assumption, and argued convincingly that parties seek not maximum votes but only sufficient votes to ensure minimally winning coalitions.

Downs's primary emphasis was on the political party, not on the behaviour of the politician or bureaucrat. This gap in early supply-side analysis was filled by Gordon Tullock who, drawing on his own experiences in the bureaucracy of the US Department of State, published his *The Politics of Bureaucracy* in 1965, although he had written the bulk of this work a decade earlier. Tullock challenged the dominant orthodoxy of modern political science and public administration, exemplified in the works of Max Weber and Woodrow Wilson, by asking the simple question: What are the rewards and penalties facing a bureaucrat located in a hierarchy and what sorts of behaviour would describe his efforts to maximise his own utility? The analysis of bureaucracy fell readily into place once this question was raised. The mythology of the faceless bureaucrat following orders from above, executing but not making policy choices, and motivated only to forward the 'public interest', was not able to survive the logical onslaught. Bureaucrats could no longer be conceived as 'economic eunuchs'. It became obligatory for analysts to look at bureaucratic structure and at individual behaviour within that structure. Tullock's work was followed by a second Downs book, and the modern theory of bureaucracy was born.

Property rights and bureaucratic behaviour

As the theory of constitutions has an affinity with the work of Rawls, so the theory of bureaucracy has an affinity with the work of those economists who have been called the 'property rights theorists', such as Armen Alchian and Harold Demsetz of UCLA, and Roland McKean of Virginia, who initiated analysis of the influence of reward and punishment structures on individual behaviour, and especially in comparisons between profit and non-profit institutions. To predict behaviour, either in governmental bureaucracy or in privately-organised non-proprietary institutions, it is necessary to examine carefully the constraints and opportunities faced by individual decision-makers.

The next step was almost as if programmed. Once we begin to look at bureaucracy in this way we can, of course, predict that individual bureaucrats will seek to expand the size of their bureaus since, almost universally in modern Western societies, the salaries and perquisites of office are related directly to the sizes of budgets administered and controlled. The built-in motive force for expansion, the dynamics of modern governmental bureaucracy in the small and in the large, was apparent to all who cared to think. This theory of bureaucratic growth was formalised by William Niskanen, who developed a model of separate budget-maximising departments and sub-departments. In the limiting case, Niskanen's model suggested that bureaucracies could succeed in expanding budgets to twice the size necessary to meet taxpayers' genuine demands for public goods and services. In this limit, taxpayers end up by being no better off than they would be without any public goods; all of their net benefits are 'squeezed out' by the bureaucrats. The implication is that each and every public good or service, whether it be health services, education, transport, or defence, tends to be expanded well beyond any tolerable level of efficiency, as defined by the demands of the citizenry.

Alongside this theory of bureaucracy, there have been efforts to analyse the behaviour of the politicians, the elected legislators, who seek opportunities to earn 'political income'. Attempts have also been made (by Albert Breton and Randall Bartlett) to integrate demand-side and supply-side theories into a coherent analysis.

V. RENT-SEEKING

To this point, I have largely discussed what we might call established ideas in public choice, although this epithet should not imply that fascinating research is not continuing in some of the areas mentioned. But let me now briefly introduce an area of inquiry, 'rent-seeking', that is on the verge of blossoming. You may, if you prefer, call this 'profit-seeking', which might be descriptively more accurate. But 'rent-seeking' is used here in order to distinguish the activity from profit-seeking of the kind we ordinarily examine in our study of markets.

Once again, we can look to Gordon Tullock for the original work on rent-seeking, although he did not originally use that term, and did not, I think, fully appreciate the potential promised in his 1967 paper.[5]

Tullock's work has been followed by papers by Richard Posner, of the University of Chicago Law School, Anne Kreuger, of the University of Minnesota, who invented the term itself, and others, but my own prediction is that the genuine flurry of research activity in rent-seeking will occur only during the next decade.

What is 'rent-seeking'?

The basic notion is a very simple one and once again it represents the extension of standard price theory to politics. From price theory we learn that profits tend to be equalised by the flow of investments among prospects. The existence or emergence of an opportunity for differentially high profits will attract investment until returns are equalised with those generally available in the economy. What should we predict, therefore, when politics creates profit opportunities or rents? Investment will be attracted toward the prospects that seem favourable and, if 'output' cannot expand as in the standard market adjustment, we should predict that investment will take the form of attempts to secure access to the scarcity rents. When the state licenses an occupation, when it assigns import or export quotas, when it allocates TV spectra, when it adopts land-use planning, when it employs functionaries at above-market wages and salaries, we can expect resource waste in investments to secure the favoured plums.

Demands for money rents are elastic. The state cannot readily

[5] 'The Welfare Costs of Tariffs, Monopolies, and Theft', *Western Economic Journal*, June 1967.

'give money away', even if it might desire to do so. The rent-seeking analysis can be applied to many activities of the modern state, including the making of money transfers to specified classes of recipients. If mothers with dependent children are granted payments for being mothers, we can predict that we shall soon have more such mothers. If the unemployed are offered higher payments, we predict that the number of unemployed will increase. Or, if access to membership in recipient classes is arbitrarily restricted, we predict that there will be wasteful investment in rent-seeking. As the expansion of modern government offers more opportunities for rents, we must expect that the utility-maximising behaviour of individuals will lead them to waste more and more resources in trying to secure the 'rents' or 'profits' promised by government.

VI. EMPIRICAL PUBLIC CHOICE

So much for a survey and narrative of the development of ideas in public choice theory. I have to this point said little about the empirical testing of these ideas or hypotheses. In the last decade, these empirical tests have occupied much of the attention of public choice economists. Indeed, to the Chicago-based group of scholars who talk about the 'economic theory of politics', the ideas that I have traced out above amount to little or nothing until they are tested; their view is that empirical work is the be-all and the end-all of the discipline. Those of us in the Virginia tradition are more catholic in our methodology; we acknowledge the contributions of the empiricists while attributing importance to the continuing search for new theoretical insights. The empiricists, among whom I should list my own colleagues Mark Crain and Bob Tollison, in addition to the Chicago group, notably George Stigler and Sam Peltzman, have taken the utility-maximising postulates and derived implications that are subject to test.

The Chicago-based emphasis has been on economic regulation of such industries as transport, broadcasting, and electricity. What is the economic model for the behaviour of the regulator and, through this, for the activities of the regulatory agency? What does the record show? Stigler suggested that the evidence corroborates the hypothesis that regulation is pursued in the interests of the industries that are regulated. Others have challenged Stigler and have tried to test the differing hypothesis that regulation is carried out for the self-interest of the regulatory bureaucracy, which may or may not coincide with the interest of the industry regulated. Little or none of the empirical work on regulation suggests that the pre-public choice hypothesis of regulation in the 'public interest' is corroborated. In the long run, this research must have some impact on the willingness of the citizenry, and the politicians, to subject more and more of the economy to state regulation, although the end does not seem yet in sight.

Crain and Tollison have looked carefully at the record for legislatures in the American states. They have used straight-forward utility-maximising models, with objectively measurable 'arguments' in the utility functions, to explain such things as relative salaries of legislators among states, relative occupational categories of legislators, committee structures in legislatures, varying lengths of legislative sessions. They have developed strong empirical support for the basic hypothesis that politicians respond to economic incentives much like the rest of us.

Political business cycles

A different area of empirical work that can be brought within the public choice framework is that on 'political business cycles', i.e. the alleged attempt by politicians in office to create economic conditions timed so as to further their own electoral prospects. This research will be more fully discussed by Bruno Frey at the seminar (Paper 4). The results seem to be somewhat mixed, and I shall not attempt to offer any judgements on this research here.

VII. NORMATIVE IMPLICATIONS OF PUBLIC CHOICE

As some of you know, my own interests have never been in the empirical tradition, as narrowly defined. I have been more interested in a different sort of research inquiry that follows more or less naturally from the integration of the demand-side and the supply-side analysis of governmental decision-making institutions.

As proofs of the logical inconsistencies in voting rules are acknowledged, as the costs of securing agreement among persons in groups with differing preferences are accounted for, the theory of rules, or of constitutions, emerges almost automatically on the agenda for research, as I have already noted. But my own efforts have been aimed at going beyond the analysis of *The Calculus of Consent*. I have tried to move cautiously but clearly in the direction of normative understanding and evaluation, to move beyond analysis of the way rules work to a consideration of what rules work *best*.

Constitutional failure: the Leviathan state

In the last five years or so, my interest has been in examining the bases for constitutional improvement, for constitutional change, for what I have called 'constitutional revolution'. My efforts have been motivated by the observation that the American constitutional structure is in disarray; the constraints that 'worked' for two centuries seem to have failed. The checks on government expansion no longer seem to exist. The Leviathan-state is the reality of our time. I state this for the US with certainty; I doubt that many of you would disagree concerning the UK.

My book, *The Limits of Liberty* (1975), was devoted to a diagnosis of this constitutional failure, a step that I considered to be necessary before reform might be addressed. (In this context, I found Nevil Johnson's 1977 book, *In Search of the Constitution*, with reference to Britain, to be congenial.) My current research emerges as a natural follow-up to the diagnosis. A first project has been completed. With Richard Wagner as co-author, we published *Democracy in Deficit* in early 1977, the theme of which is restated and applied to Britain with John Burton in the IEA's Hobart Paper No. 78, *The Consequences of Mr Keynes* (published on 28 April, 1978). The book was an attempt to examine the political consequences of Mr Keynes, and the central theme was to the effect that an important element of the American fiscal constitution, namely the balanced-budget rule, had been destroyed by the political acceptance of Keynesianism. Economists blindly ignored the asymmetry in application of Keynesian policy precepts, an asymmetry that the most elementary public choice theorist would have spotted. They naïvely presumed that politicians would create budget surpluses as willingly as they create deficits. They forgot the elementary rule that politicians enjoy spending and do not like to tax.

In *Democracy in Deficit*, Wagner and I called explicitly for the restoration of budget balance as a constitutional requirement. With Geoffrey Brennan, I am now engaged in an attempt to design a 'tax constitution'. We are examining ways and means through which the revenue-grabbing proclivities of governments might be disciplined by constitutional constraints imposed on tax bases and rates.

Can government be constrained?

These efforts, on my part and others, suggest that we proceed from a belief that governments can be constrained. We refuse to accept the Hobbesian scenario in which there are no means to bridle the passions of the sovereign. Historical evidence from America's own two centuries suggests that governments can be controlled by constitutions.

In one sense, all of public choice or the economic theory of politics may be summarised as the 'discovery' or 're-discovery' that people should be treated as rational utility-maximisers in *all* of their behavioural capacities. This central insight, in all of its elaborations, does not lead to the conclusion that all collective action, all government action, is necessarily undesirable. It leads, instead, to the conclusion that, because people will tend to maximise their own utilities, institutions must be designed so that individual behaviour will further the interests of the group, small or large, local or national. The challenge to us is one of constructing, or re-constructing, a political order that will channel the self-serving behaviour of participants towards the common good in a manner that comes as close as possible to that described for us by Adam Smith with respect to the economic order.

VIII. THE WISDOM OF CENTURIES

I have described the economic theory of politics, or public choice, as a relatively young subdiscipline that has emerged to occupy the attention of scholars in the three decades since the end of World War II. If we look only at the intellectual developments of the 20th century, public choice is 'new', and it has, I think, made a major impact on the way that living persons view government and political process. The public philosophy of 1978 is very different from the public philosophy of 1948 or 1958. There is now much more scepticism about the capacity or the intention of government to satisfy the needs of citizens.

At the start of my remarks, I stated that the ideas of public choice have been relatively slow to catch on in the UK. That statement is, I think, accurate, but I should be remiss if I did not end this paper on a somewhat different note. In one sense, public choice—the economic theory of politics—is not new at all. It represents rediscovery and elaboration of a part of the conventional wisdom of the 18th and the 19th centuries, and notably the conventional wisdom that informed classical political economy. Adam Smith, David Hume, and the American Founding Fathers would have considered the central principles of public choice theory to be so elementary as scarcely to warrant attention. A mistrust of governmental processes, along with the implied necessity to impose severe constraints on the exercise of governmental authority, was part and parcel of the philosophical heritage they all shared. This set of attitudes extended at least through the middle years of the 19th century, after which they seem to have been suspended for at least a hundred years. Perhaps they are on the way to return.

I could scarcely do better in conclusion than to introduce a citation from J. S. Mill's *Considerations on Representative Government* (1861):

> '. . . the very principle of constitutional government requires it to be assumed, that political power will be abused to promote the particular purposes of the holder; not because it always is so, but because such is the natural tendency of things, to guard against which is the especial use of free institutions'.[6]

How much have we forgotten? Can modern man recover the wisdom of the centuries? Let us not despair. A start has been made.

BASIC REFERENCE WORKS IN PUBLIC CHOICE

Arrow, Kenneth, *Social Choice and Individual Values,* New Haven: Yale University Press, 2nd edition, 1970.

Bartlett, Randall, *Economic Foundation of Political Power,* New York: Free Press, 1973.

Black, Duncan, *The Theory of Committees and Elections,* Cambridge: Cambridge University Press, 1958.

[6] J. S. Mill, *Considerations on Representative Government* (1861), in J. S. Mill, *Essays on Politics and Society*, Vol. II, University of Toronto Press, Toronto, 1977, p. 505.

——, and Newing, R. A., *Committee Decisions with Complementary Valuation,* London: William Hodge, 1951.

Breton, Albert, *The Economic Theory of Representative Government,* Chicago: Aldine, 1974.

Buchanan, James M., *Fiscal Theory and Political Economy,* Chapel Hill: University of North Carolina Press, 1960.

——, *Public Finance in Democratic Process,* Chapel Hill: University of North Carolina Press, 1967.

——, *The Limits of Liberty: Between Anarchy and Leviathan,* Chicago: University of Chicago Press, 1975.

——, *Freedom in Constitutional Contract,* College Station: Texas A and M University Press, 1978.

——, and Tullock, Gordon, *The Calculus of Consent: Logical Foundations of Constitutional Democracy,* Ann Arbor: University of Michigan Press, 1962.

——, and Wagner, Richard E., *Democracy in Deficit: The Political Legacy of Lord Keynes,* New York: Academic Press, 1977.

——, and Tollison, Robert (eds.), *Theory of Public Choice,* Ann Arbor: University of Michigan Press, 1972.

Downs, Anthony, *An Economic Theory of Democracy,* New York: Harper, 1957.

——, *Inside Bureaucracy,* Boston: Little Brown and Company, 1967.

Niskanen, William A., *Bureaucracy and Representative Government,* Chicago: Aldine, 1971.

Olson, Mancur, *The Logic of Collective Action,* Cambridge, Mass.: Harvard University Press, 1965.

Riker, William, *The Theory of Political Coalitions,* New Haven: Yale University Press, 1962.

——, and Ordeshook, Peter, *An Introduction to Positive Political Theory,* Englewood Cliffs, N.J.: Prentice Hall, 1973.

Sen, A. K., *Collective Choice and Social Welfare,* San Francisco: Holden Day, 1970.

Tullock, Gordon, *The Politics of Bureaucracy*, Washington: Public Affairs Press, 1965.

——, *Private Wants, Public Means,* New York: Basic Books, 1970.

——, *Towards a Mathematics of Politics,* Ann Arbor: University of Michigan Press, 1972.

——, *The Social Dilemma*, Blacksburg: Center for Study of Public Choice, 1974.

Wicksell, Knut, *Finanztheoretische Untersuchungen,* Jena: Gustav Fischer, 1896. A major portion of this work is translated and published under the title 'A New Principle of Just Taxation', in R. A. Musgrave and A. T. Peacock (eds.), *Classics in the Theory of Public Finance,* London: Macmillan, 1959.

Note: References above are limited to books. A listing of article-length contributions would extend to many pages. See the Bibliography in Dennis Mueller's survey paper in *Journal of Economic Literature,* Vol. 14, No. 2 (June 1976), pp. 395-433.

PART II

The Seminar Papers

Morning Session Chairman: ***Lord Robbins***

Introductory Remarks

Rt. Hon. JO GRIMOND, MP

The Authors

The Chairman:
LORD ROBBINS: Sometime Professor of Economics and Political Science, University of London (LSE). Director of Economics Section, War Cabinet, 1941-45. Chancellor of Stirling University. Chairman of the *Financial Times,* 1961-71. Chairman of Committee on Higher Education, 1961-63. Author of *The Nature and Significance of Economic Science.*

JO GRIMOND: Member of Parliament for Orkney and Shetland. Leader, Parliamentary Liberal Party, 1956-67, and May-July 1976. Chancellor, University of Kent at Canterbury, since 1970; Director, The Manchester Guardian and Evening News, since 1967. Author of *The Liberal Future*, 1959; *The Liberal Challenge*, 1963; (with B. Neve) *The Referendum*, 1975; *The Common Welfare,* 1978. For the IEA he contributed an essay, 'Trade Unions Harm the Poor', in *Trade Unions: Public Goods or Public 'Bads'?*, Readings 17, 1978.

Rt. Hon. JO GRIMOND, MP:

May I thank the promoters of this conference very much for inviting me to it?

Democracy must be for ever on the alert to accept new factors in politics, and it then has to adapt its methods and its institutions to deal with them. We too readily assume that the 18th-century model of democracy is still in full flower, but it is withering. As a contribution to the process of examining democracy, this Seminar might be described therefore as a discussion in political engineering and should to some extent be considered as such; but the engineer must have an idea of what the engine he is tinkering with is designed to do.

I would say the failures of politics are always due to double failures: losing sight of our aim and failing to devise means to achieve it. It is true, as Professor Buchanan says in his lecture, neither blue nor green is the true colour for a school house; but if you are designing a school house it is important to remember that it is intended for the education of children.

I find all the seminar papers of fascinating interest, and if I pick on some points this does not imply any general criticism of the argument, with which I largely agree. As a practising politician but not a Minister, I am particularly interested in why the lessons these papers teach have not been more widely appreciated. Professor Breton says that politicians and bureaucrats maximise power. This is not always true. Often they are content with office, even without power. It is not even true that they are always maximising the length of time in office. If this were indeed their main aim, the two top items in the programme of the British Tories would be proportional representation and Home Rule for Scotland and Wales. If they achieve those aims they will be in office for ever. The Liberal Party, of course, would have ceased to exist long, long ago if office were the only aim of politicians.

British political parties becoming bureaucracies

Professor Buchanan's lecture (Part I) is, as he says, concerned with private preferences. Naturally neither he nor other contributors deal at any length with the position of the political parties. The parties are, in Britain at least, undergoing very important changes. They themselves are becoming bureaucracies, and like all bureaucracies they look more and more to the state to keep them going. Were it not for legislation on the political levy of the unions, the Labour Party would not exist. It raises little money by voluntary contributions. I suspect that all parties in this country will soon be entirely state-financed because they are finding it impossible to keep themselves by any other means in conditions they would like to think they must have. They have really very little popular support.

An important development is that each Party receives a considerable sum of money for research. The researchers have an interest in producing elaborate Party programmes much of which is irrelevant to our problems and nearly all unwanted by the electorate. Professor Buchanan says they tend to be expanded well beyond a tolerable level of efficiency as defined by the demands of the citizenry and that they are a very important new factor in the Party set-up. The increase of payments in kind and perks enjoyed by politicians, including Ministers, are certainly altering our attitudes and our work. We no longer really share the problems of our constituents. We are becoming a separate interest on our own, and to some extent a pressure group for ourselves.

A counter-bureaucracy?

Professor Peacock's admirable paper should be followed up by three inquiries. First, what is the proper field for the civil service bureaucrat? Anyone who has worked with them knows, as Professor Peacock says, that they are in many ways admirable and exceptionally loyal and they must really be capable of rather better performance than we get from them. Second, is there a bigger place for a counter-civil service, either by the Ombudsman or even on such things as the strategic studies and so forth? Third, what is the future of the specialist parliamentary committee? Should it have a small civil service of its own?

Professor Wiseman's paper explains with the utmost clarity the functioning of the nationalised industries, or their malfunctioning, but naturally makes no full estimate of what I regard as one of the most important of their results: the huge waste of investment and savings. If this country is short of investment it is largely because, although we have large savings, we waste them. We pour them into totally uneconomic projects, among which the nationalised industries are high up on the list.

Next, if we were to run them down, to either thin out the numbers employed or turn them on to the market, which would certainly lessen the number of people employed, what would we do with the unemployed? A very important aspect of the nationalised industries in this country is that, in a way, they are a modern development of the old Poor Law. They are a way of providing jobs for people who otherwise would not get them in the good old 18th-century manner; something else would have to be done about them.

Government economic/electoral cycles

There is a lot of empirical evidence on budgets to support Professor Frey's contention that governments produce cycles to suit their electoral chances. There is also some evidence that they do not. And occasionally they disregard the Gallup Polls! Mr Heath's abolition of retail price maintenance, for instance, was considered to be exceptionally unwise immediately before the 1964 General Election. Indeed, what are governments to do? This is now a recurrent theme. A government is now one interest battling with many other interests in the state which are extremely strong. If it does not use the machinery of the state to protect its own interest, how is it going to deal with these other interests?

Government's power to protect itself

We no longer live in a perfect liberal world in which governments can be impartial. They are now involved in every sort of economic and other activity; naturally they use the power that *that* gives them to get what they want. It seems to be quite incredible, for instance, that they go on financing the National Union of Students, which does nothing but attack them. I do not believe they will go on doing it. I think one day the boys and girls will be cut off.

Finally, in coming to any conclusion about how the future of our political economy can be improved, we must re-state the role of the Opposition. In this connection we must make allowances for some successes. It is rather alarming that some of them have been achieved outside the political system by people in planning inquiries and so forth, relying on a certain amount of disruption. But there has been some success lately in curbing bureaucracy. The immediate test of success of British democracy is over the closed shop. This is not only the most potent current attack on liberty; it also weakens loyalty to institutions, it distorts the free dissemination of ideas and information, it stifles initiative, and it breeds inefficiency. It is also the most obvious symptom of a frame of mind which these papers criticise.

When I say 'the politicians' own interest'—and this is borne out by the papers—it is also true that they are a victim. More and more we find ourselves pushed around by other powerful interests seeking in one form or another either a rent position, as mentioned by Professor Buchanan, or a closed shop. As a result of this interplay, fascism in this country today does not come from the National Front but from certain elements amongst supporters of the Labour Party.

What I hope these papers will achieve, apart from most valuable new theories to enable us to grapple with developments of our time, is resurgence and encouragement of politicians to revive the skilled practice of politics. At present we too often use the vast resources of the state for the wrong purposes. We do not use its patronage, its huge disposals, to reward people who have behaved with public spirit or with economy or who have reduced their empires. On the contrary, we reward the very individuals and organisations which are doing their best to harm the sort of society that I at any rate believe has value.

In these circumstances what should liberals do? Accept that they are themselves an interest, form themselves into interest-groups, and resort to the methods of other interests in the country? Or try to convince the people at large that the liberal society is worth working for, and that an impartial government looking after the general interest is not a wholly out-of-date conception?

These papers should encourage not only us but also governments to understand better where our hopes and fears should lie, and to act accordingly in the matters directly under their control.

LORD ROBBINS (*Chairman*): Thank you, Mr Grimond, for that candid and realistic survey of the whole horizon which we are to map out in our discussions today. This is essentially an interdisciplinary conference with a difference. In my young days it was assumed that economics would be studied side by side with other disciplines which were supposed to shed light on our subject. I am not sure that the practice prevails, at any rate south of the border, at the present day. When in my lectures I humbly digress to answer some question relating to general affairs or general culture, it is usually an Indian or a German who provides the right answer to my question.

Today we are seeking not so much to ask what light politics and history throw on economics but the reverse question: In what sense does economic analysis throw light on the problem we have to investigate in the political sphere?

We meet today having heard the splendid survey of the literature and his own contribution in the lecture yesterday by Professor Buchanan. We have a very representative collection of papers the contents of which miraculously Mr Grimond managed to talk upon in his brief opening remarks.

I call upon Professor Rowley to deliver the first paper: 'Market "Failure" and Government "Failure" '.

1. Market 'Failure' and Government 'Failure'

CHARLES K. ROWLEY
University of Newcastle upon Tyne

The Author

Charles K. Rowley: Professor of Economics since 1972, and Director of the Centre for Research in Public and Industrial Economics, University of Newcastle upon Tyne, since 1974. Formerly, Universities of Nottingham (1962-65), Kent (1965-70), and York (1970-72).

Author of *The British Monopolies Commission,* 1966; *Steel & Public Policy,* 1971; *Antitrust and Economic Efficiency,* 1972; (with A. T. Peacock) *Welfare Economics: A Liberal Restatement,* 1975; and many articles. For the IEA he contributed two essays, 'Public Preference for Market Processes', in *Catch '76. . .?,* Occasional Paper 'Special', No. 47, 1976, and 'Taxing in an International Labour Market', in *The State of Taxation,* Readings 16, 1977.

CHARLES K. ROWLEY:

Welfare economists, with few exceptions, have facilitated the advance of the state in post-war Western economies *via* excessive reliance upon an analytical approach which suffers from a number of serious defects.

First, they have endorsed an ideology, Arrowian collective choice (after Professor Kenneth Arrow), which, despite its apparent emphasis upon the primacy of individual preferences, nevertheless results in collectivist economy when individual preferences themselves are sufficiently interventionist or 'meddlesome'.

Secondly, and in part as a consequence of Arrow's approach, they have promulgated the false notion of an omniscient and impartial government, an abstraction which responds costlessly and effectively as the rectifier of market failure.

Thirdly, they have failed to take account of recent theories of representative government which offer a far less favourable analysis of the behaviour of government in the process of public choice.

Fourthly, they have paid little or no attention to the problem of devising a constitution capable of controlling the more 'meddlesome' implications of representative government and, in particular, of safeguarding the liberties of individual citizens.

Fifthly, by emphasising the importance of ends and playing down the relevance of means, economists have lost sight of John Stuart Mill's famous dictum that 'It really is of importance, not only what men do, but also what manner of men they are that do it'.[1]

I. ARROWIAN COLLECTIVE CHOICE AND SYNOPTIC DELUSION

Arrow's starting point in his far-reaching contribution to the theory of collective choice [2] certainly appears to be individualistic, with each individual in society assumed to have a well-defined preference ordering (i.e. to be able to rank in terms of preference or indifference) over all possible social alternatives with which he might be confronted. Individual orderings, however, are unlikely to contain a sufficient basis for collective choice in view of the diversity of individual preferences. A problem arises on how individual orderings are to be aggregated into what is termed a 'welfare judgement'. This problem revolves around the choice of a rule, or constitution, for selecting a socially preferred action given all individuals' preference profiles over feasible alternatives.

To assist economists in this exercise, Arrow put forward a number of 'desirable characteristics' which he suggested would appeal to all individuals who set about the task of establishing a constitution, namely

(i) the condition of collective rationality;
(ii) the Pareto condition;[1]
(iii) the condition of non-dictatorship; and
(iv) the independence of irrelevant alternatives.

These conditions are clearly expounded in all texts on welfare economics [3]. Suffice it to say that Arrow proved, in his famous Impossibility Theorem, that these 'desirable characteristics' are contradictory in the sense that it is always possible to find profiles of individual preferences such that any constitution must violate at least one of its desired properties. For this, more than for any other contribution, Arrow received a Nobel Prize.

Arrow's real legacy

Yet what is the real legacy of Arrow's contribution to the economic theory of public policy? I suggest it does not lie essentially in the Impossibility Theorem itself, despite the enormous literature which has developed around it, but rather in two unfortunate paradigms, or convenient fictions, which now dominate collective choice analysis, namely the paradigm of the dictatorial social decision-maker and the paradigm of omniscient and impartial government. In combination, these two convenient fictions have rendered market economics highly susceptible to collectivist attack when economists concern themselves with issues of policy.

---

[1] The Pareto condition is a condition of allocative efficiency. It prescribes for a socially optimal allocation of resources the efficiency criterion that it is not possible to change the allocation of resources, increasing quantities of some goods and reducing quantities of others, without making someone (or some group) worse off than before. Thus, if it is possible to re-allocate resources so that some people are better off (in the sense that they prefer the second situation to the first) *without making anyone else worse off*, then the existing pattern of resource allocation is not economically efficient. If a particular allocation of resources meets this Pareto criterion of efficiency, it is said to be 'Pareto-optimal'.

The paradigm of the dictatorial social decision-maker (analysed by Sugden [4]) was endorsed explicitly by Arrow [5], following criticism by Little [6] to the effect that his collective choice analysis implied totalitarian notions. Unlike Little and Bergson [7], who were both concerned to ensure that individuals participated fully in collective choice, Arrow was fully determined that they should not. Indeed, he went so far as explicitly to endorse a notion condemned by Bergson in which collective choices are to be effected by advising, not citizens generally but public officials, and to assert that the values to be referred to should *not* be those which would guide the official were he a private citizen. In this paradigm, collective choice is interpreted as a two-stage procedure, in which the first stage—the choice of a constitution—requires the public official to inject his own ethical beliefs and in the second stage to choose between alternative social actions by applying this constitution to the profiles of individual preferences with which he is assumed to be familiar. In such a system, the public official is a dictator, no matter how benevolent the dictatorship.

'Constructivist rationalism'—the fallacy of 'synoptic delusion'

The paradigm of omniscient and impartial government—the assumption that full information is available to society (or the social decision-maker) concerning all individual preferences, and that social welfare will be maximised by reference to rules strictly adhered to—is central to Arrowian collective choice theory. This view of the state is derived from a philosophic approach which Hayek [8] has designated as 'constructivist rationalism'. It was first fully developed by Descartes [9] and consolidated by Hobbes [10] and Rousseau [11] into the notion of the 'social contract'. Constructivist rationalists base their approach on the false assumption that all relevant facts are known to one mind and that it is possible to construct from them the particulars of a desirable social order. This fallacy has been designated by Hayek [12] as 'synoptic delusion'. For, in reality, societies are highly complex, individuals' preferences over alternative social states are not widely known, nor are they especially stable. No single mind could possibly be fully informed at any point about the precise configuration of individual preferences over all alternative social states, to say nothing about the manner in which the preferences are likely to adjust themselves. But the convenient fiction that such knowledge is indeed possible has enabled some economists to promulgate planning frameworks for society in which individual preferences would be costlessly transformed into collective choices.

The necessity of collective choice: false paradigms

Clearly, collective choice is necessary in all but the most primitive of societies, if only to provide the minimal amount of law and order essential for society to exist. For even if informal rules are highly regarded, the public good characteristics of enforcement procedures[2] will require the creation of a collective body such as government to act as referee. Nor indeed is it likely that the informal rules will always be sufficiently widely accepted or sufficiently developed for the requirements of society, with the inference that the collectivity may be required to fulfil a legislative function. Finally, of course, the responsibilities of the collectivity are unlikely in practice to be restricted to these general policing and legislative functions, since spontaneous orders are unlikely to capture all the gains available from trade, given the public good characteristics of some commodities and the existence of other external effects. In such circumstances, the collectivity will fulfil additional functions in providing commodities itself, such as defence, medicare or education, and in creating or adjusting markets where they do not exist or are judged defective.

In each of these separate but related functions of a collectivity, the application of the false paradigms of the dictatorial social decision-maker and of omniscient and impartial government must bias policy recommendations in favour of government and against the spontaneous market order. Moreover, the nature of the bias is likely to be such, as I shall indicate later, as to induce an excessive amount of highly specific government intervention of an especially inefficient kind. To such an outcome Arrowian collective choice analysis has contributed not a little over the past quarter-century. It has much to answer for.

[2] Law enforcement procedures are not subject to rivalry in consumption nor to exclusion of consumers—both of which render normal market provisions difficult.

II. MEDDLESOME PREFERENCES AND PARETIAN INTERVENTIONISM

Until recently, many economists considered that the emphasis placed upon the Pareto principle in Arrow's collective choice was a sufficient safeguard against excessive interventionism concerning choices which lay within what Hayek has referred to as the 'protected sphere' (e.g. whether a person sleeps on his back or on his belly, whether he lives in London or in Newcastle, or whether he does or does not read a particular saucy book). In an important paper, in 1970, however, Amartya Sen demonstrated [13] that the Pareto principle is incompatible with even minimal liberalism, when individual preferences exhibit meddlesome tendencies. I shall illustrate Sen's more general proof of the impossible Paretian liberal by a simple example.

An illustration of 'minimal liberalism' and the Pareto principle

Let us define the weak Pareto principle (Condition P) as implying that whenever *all* citizens prefer alternative *a* to alternative *b* the *collective* decision rule also should order *a* as preferred to *b*. Let us define minimal liberalism (Condition L) as allowing each individual to be decisive in collective choice over at least one pair of social outcomes (i.e. if Man A or Man B prefers to sleep on his back and not his belly the collective decision rule should so register). Finally, let us follow Arrow in requiring the collective decision rule to be capable of ordering social states for all possible profiles of individual preferences. This is called the unrestricted domain requirement or Condition U.

Let us now consider a society comprising two individuals, Man A who is a prude and Man B who is lascivious, and a social alternative involving a book, *Lady Chatterley's Lover,* which can be read either by Man A, Man B, or neither. It is easy to establish that there is no collective choice rule which can guarantee to satisfy simultaneously the three conditions, P, L and U. Suppose Mr A (the prude) would rank most highly the outcome that the book should not be read; but if it is to be read he would read it himself rather than let Mr B enjoy it. Suppose that Mr B (the lascivious) would rank most highly the outcome that Mr A should read the book (it will do him good), but would read it himself rather than see a good book go to waste. According to Condition P, the collective choice rule should register the outcome that Mr A reads the book is socially preferable to Mr B reading the book. But according to Condition L, Mr A prefers not to read the book whilst Mr B prefers to read the book. Clearly, the results are internally inconsistent and the collective choice rule will fail to provide a unique ordering of social alternatives.

Economists have preferred Pareto to Sen

It should come as no surprise to find that the large majority of the economists who have contributed to the debate generated by Sen's contribution (Sen himself excepted) have preferred to go against Condition L rather than against Condition P in their attempts to resolve the collective choice dilemma. For Condition P (the Pareto principle) exercises a very powerful influence in the economic analysis of public policy and indeed dominates both the textbook and the journal literature. It would seem unlikely, therefore, that liberal precepts will deter economists from pressing for meddlesome collective choices in societies where individual preferences themselves are meddlesome. Sen probably is realistic in commenting that

> 'the ultimate guarantee for individual liberty may rest not on rules for social choice but on developing individual values that respect each other's personal choices' (Sen, 1976, pp. 155-6).

Finally, it is noteworthy that those who have engaged in this debate (Peacock and Rowley [14], Sugden [5], and Rowley [15], excepted) have adopted without apparent question the paradigms of Arrowian collective choice theory. That these paradigms are in direct conflict with liberal philosophy—and the implication that Arrow's approach cannot incorporate Condition L at all—goes either ignored or unrecognised. Such is the danger of playing with false paradigms in analytical economics.

III. THE ECONOMICS OF REPRESENTATIVE GOVERNMENT

For Arrow and his disciples, the collectivity is an abstract concept based on the notion of a social decision-maker who abides by certain ethically desirable rules in moving from profiles of individual preferences to associated collective choices. In reality, the principal instrument of collective choice is representative government, elected in democratic societies by some voting rule, notably by some form of majority vote. Recent contributions to the positive analysis of the behaviour of government, commencing with the early contributions by Buchanan and Tullock [16], Downs [17], and as extended by Breton [18], Niskanen [19] and others, do not suggest that representative government is either omniscient or impartial. Indeed, certain implications of the public choice analysis raise serious questions concerning the possibility of preserving individual freedoms against meddlesome behaviour under a system of majority-vote representative government in the absence of inbuilt constitutional safeguards.

The public choice approach: political market analysis

In essence, the public choice approach attempts to analyse the process of collective decision-making by reference to techniques which have proved successful in analysing private decision-making. Public policies are viewed as the outcome of the forces of demand and supply as they impinge on the political market-place. Individual citizens are assumed to make known the profile of their individual preferences over alternative social states to the extent that they deem to be economic. And they attempt to influence government to satisfy those preferences by resort to the instruments available, notably by voting, by pressure-group and social movement activities, by private provision, by migration or even by revolution. Political parties are viewed as coalitions which 'log-roll'[3] on electoral platforms designed to satisfy a variety of objectives, such as power, patronage, ideology, private income and probability of election. The government is viewed as maximising such objectives during its period of office subject to some constraint defined on the probability-of-election variable. A further important influence in the supply of public policies is seen to stem from bureaucracy, with senior bureaucrats viewed as maximising their utility in terms of the specific reward-cost structure which confronts them.

Such an approach to the determination of public policy conflicts sharply both with the paradigms of Arrowian collective choice theory and with Platonic notions of government which still haunt many corridors in political science establishments. Not surprisingly, the approach has encountered resistance from economists and political scientists from a variety of methodological positions. Marxists have attacked the notion that a positive, non-value-laden analysis of political behaviour is even possible, claiming that those who engage

[3] Log-rolling is the process whereby politicians trade policies for mutual support.

in such an exercise are prone to an illusion which they designate to be 'false consciousness', in which abstractions are idealised and then are mistaken for reality itself. In short, they view the public choice approach essentially as an attempt to protect corrupt systems of government.

Criticisms of public choice theory

Those who attach importance to realism of assumptions in positive theory often find it difficult to countenance the strong maximising assumptions which generate the public choice approach, reject many or even all of the factors considered relevant to politicians' behaviour, find unacceptable such characteristics of public choice models as, for example, Breton's extreme reliance on the public good characteristics of collective choice [18], and deny that the complex processes of politics can be captured adequately in an abstract model.

Those who emphasise prediction as the ultimate test of theory have complained that many public choice models are inadequately specified, that they fail to provide unambiguous predictions on key political market variables, such as the size of a budget deficit or the pattern of subsidies adopted, that they introduce variables such as power and patronage which cannot adequately be measured in empirical analysis, that they leave important relationships ill-defined (e.g. the determinants of the relative power of government and its bureaucracy in Breton's model), and that, in any event, public choice analysts are more concerned with model-building than with model-testing.

It would be unwise to ignore the partial justice of each of these criticisms. For there can be little doubt that some public choice analysts are influenced by ideological considerations and that it is very easy to confuse paradigms with reality, that not all the assumptions employed in public choice theory are equally convincing, that not all the predictions of public choice models would stand up equally well to appropriate tests, and that empirical research is an exhausting exercise. For all these reasons, the critics of public choice analysis require serious consideration from those concerned to advance understanding of the political market-place.

Equally, however, it would be foolhardy to reject one method of approaching an important subject on the ground that it has weaknesses evident in all scientific analysis. Public choice is a young discipline (at least in its modern form), and it encounters all the well-known problems of straddling diverse disciplines. Certainly, its theoretical structure has been developed from relatively primitive initial forms, and the tests to which it has been exposed have been fairly simple and subsequently often proved unacceptable. But this is true of any emergent discipline. What is clear is that public choice analysis now is establishing credibility in professions which initially were hostile to its reception. The journal of the Society, *Public Choice,* is now highly-rated by ambitious faculties and by academics striving to make their way within a highly competitive profession. Articles with public choice analysis now appear regularly in other leading journals of economics and political sciences, as well as in more popular avenues of communication.[4] Scientists are jealous guardians of their disciplines and new ventures are not easily accommodated. Judged by the market test itself, public choice analysis is now accepted and its future in foreseeable time seems indisputably attractive.

IV. SOME IMPLICATIONS FOR GOVERNMENT 'FAILURE'

What are the implications for political market behaviour?

First, as Breton has demonstrated, the precise voting rule is important when assessing the critical level of electoral support required for political survival. In a parliamentary system of the British type, a simple majority rule operating in the constituency to select representatives and in government to select the party that will govern implies that the preferences of approximately only one-quarter of the electorate may be represented by the collectivity. By contrast, the rules governing the choice of the President and of the governors of each state in the American congressional system require the support of a larger fraction of the electorate. If a society is concerned to prevent a minority of the electorate from controlling the apparatus of government, therefore, the British model fares less well than the American model. Similarly, it is widely recognised that proportional representation, in comparison with the 'first-past-the-post' system, increases the minimum size of the group of citizens whose preferences a governing party must satisfy (in principle to

[4] For example, the publications of the Institute of Economic Affairs, the Bank Reviews and *New Society.*

50 per cent), since only by holding a majority of the popular vote can a government hold a majority of representatives.

Secondly, public choice analysis emphasises the role of the electorate (or rather of the decisive voter sub-group) in establishing the demand for public policies. Insofar as collective choice is deemed necessary to correct for deficient choices in the private sector (as many economists argue for education and medicare, for example), the question is posed whether voters (the same citizens) will make less deficient choices *via* the ballot box. Can we assume that their deficiencies evaporate as they move from private into collective choice? Furthermore, if Professor Mancur Olson [20] is right in suggesting that producer groups, broadly defined, will tend to dominate consumer groups in influencing political behaviour, as a consequence of the free-rider principle, if Professor Peter Bernholz [21] is right in suggesting that this dominance will be intensified as a consequence of the privileged access of producer groups to information which may influence political outcomes, and if G. Daly and A. Giertz [22] are right in asserting that producer groups may subvert votes by the threat of harm to third parties, in pursuit of their objectives, what inferences might we draw about comparative consumer sovereignty in the private and in the political market-place or indeed about comparative efficiencies in production? The answer must be that consumer sovereignty will be greater and efficiency will be greater in the private market-place.

Thirdly, if government becomes highly dependent upon its bureaucracy for information flows—and this dependency is typical of the complex industrial nations—and if the reward-cost structure facing bureaucrats is such, as Niskanen and Olson have both urged, as to induce the senior bureaucrats to maximise the rate of growth of their bureaus, it is predictable both that bureau-dominated collective provisions will be excessive by reference to voter preferences and that bureaus typically will not be budget-constrained but will supply their outputs inefficiently. To the extent that power is also an important objective of producer groups and of the senior bureaucrats, it is also predictable that the degree of meddlesomeness of legislation and administrative intervention will exceed that of the decisive voter sub-group.

Fourthly, and self-evidently, public choice analysis does not offer a high probability that representative government will reflect at all Samuelson's convenient fiction of 'the omniscient calculating machine' [23], carefully weighing marginal evaluations of cost and benefit to determine the optimal allocation of collective goods, given the prevailing distribution of income. Recognition that the Arrowian and Paretian fictions do not correspond to each other or to the real world of representative government is essential if welfare economists are not to continue to waste their efforts in devising utopian collective choice solutions to apparent problems of market failure without reference to the deficiencies of the political market.

V. MEDDLESOME COLLECTIVE CHOICES AND CONSTITUTIONAL REFORM

Even an Arrowian constitution thus cannot guarantee simultaneously to uphold liberal and Paretian principles in a society characterised by meddlesome (individual) preferences. I have suggested that the nature of representative government—especially the parliamentary system of the UK type—is susceptible to meddlesome behaviour even when a majority of the electorate is not in favour of meddlesome government. Furthermore, in circumstances where a decisive voter sub-group *is* meddlesome, the system of representative government itself offers no defence against the establishment of the totalitarian state. Recognition of this threat, by public choice analysts who value freedom, has led to important recent contributions to value-laden or *normative* public choice.

Essentially, such contributions have been 'contractarian' in nature, seeking gains-from-trade in freedom under various specified conditions. In the one approach by John Rawls (the Harvard philosopher) [24], an attempt is made to seek out the likely implications for the collectivity of a constitution determined by individuals who cast their votes behind a 'veil of ignorance' which precludes them from all knowledge of their likely position in society. In the view of Rawls, such a constitution would attach great importance to the maintenance of freedom, indeed placing it foremost and inalienably as a basis for society.

More recently, Professor Buchanan [25] also has explored the likely conditions under which universal consent might be forthcoming for a constitutional contract which preserved liberty and controlled representative government, even when individuals were fully aware of their place in society. His analysis leads him to a degree of optimism concerning the gains-from-trade available to induce the necessary degree of co-operation. Fear of the Hobbesian jungle with its emphasis upon predation and defence, in Buchanan's view, will generate agreement.

I am more pessimistic. Individuals in society are becoming increasingly meddlesome, and constitutional safeguards, even in the USA with its 'constitution of liberty', have proved inadequate for the reining-in of representative government from meddlesome acitvities. Even if it were true that a majority of those who were meddlesome gained less from meddling than they lost from being meddled with—and this is all that would be required for their endorsement of a liberal constitution—a dilemma remains. Should one be concerned that a minority is to be forced to be free? Or should one trim one's course and be grateful for the majority and encourage it in its activities, confident that those who yet are afraid of freedom will benefit from its existence? It is perhaps significant that the constitution of the USA, described by Hayek as 'A Constitution of Liberty', was imposed upon that society by the 'Founding Fathers' who themselves were as convinced a group of constructivist rationalists as one might expect to encounter.

REFERENCES

[1] Mill, J. S., *On Liberty,* Ch. 3, p. 73.

[2] Arrow, K. J., *Social Choice and Individual Values,* Yale University Press, New Haven, Con., 2nd Edition, 1970.

[3] Winch, D., *Analytical Welfare Economics,* Penguin Books, 1973.

[4] Sugden, R., 'Social Choice and Individual Liberty', AUTE Proceedings, 1978 (forthcoming).

[5] Arrow, K. J., 'Values and Collective Decision-making', in Peter Laslett and W. Runciman (eds.), *Philosophy, Politics and Society,* Vol. III, Blackwell, Oxford, 1967.

[6] Little, I. M. D., 'Social Choice and Individual Values', *Journal of Political Economy,* 1954, pp. 422-32.

[7] Bergson, A., 'On the Concept of Social Welfare', *Quarterly Journal of Economics,* 1954, pp. 233-52.

[8] Hayek, F. A., *The Constitution of Liberty,* Routledge & Kegan Paul, London, 1960.

[9] Descartes, René, *Principles of Philosophy,* Everyman's Library No. 570, Dent, London.

[10] Hobbes, Thomas, *Leviathan,* Everyman's Library No. 691, Dent, London.

[11] Rousseau, J. J., *The Social Contract* and *Discourses,* Everyman's Library No. 660, Dent, London.

[12] Hayek, F. A., *Law, Legislation and Liberty:* Vol. I, *Rules and Order,* Routledge & Kegan Paul, London, 1973.

[13] Sen, A., 'The Impossibility of a Paretian Liberal', *Journal of Political Economy,* Vol. 78, No. 1, 1970, pp. 152-57.

[14] Rowley, C. K., and Peacock, A. T., *Welfare Economics: A Liberal Restatement,* Martin Robertson, London, 1975.

[15] Rowley, C. K., 'Liberalism and Collective Choice: A Return to Reality?', *Manchester School,* September 1978.

[16] Buchanan, James, and Tullock, Gordon, *The Calculus of Consent,* Ann Arbor, Michigan, 1965.

[17] Downs, Anthony, *An Economic Theory of Democracy,* Harper and Row, New York, 1957.

[18] Breton, Albert, *The Economic Theory of Representative Government,* Macmillan, London, 1974.

[19] Niskanen, W. A., *Bureaucracy and Representative Government,* Aldine, Chicago, 1971.

[20] Olson, Mancur, *The Logic of Collective Action,* Harvard University Press, Cambridge, Mass., 1965.

[21] Bernholz, Peter, 'Liberalism, Logrolling and Cyclical Group Preferences', *Kyklos,* Vol. 29, 1976, pp. 26-38.

[22] Daly, G. and Giertz, A., 'Benevolence, Malevolence and Economic Theory', *Public Choice,* Autumn 1972.

[23] Samuelson, P., 'The Pure Theory of Public Expenditure', *Review of Economics and Statistics,* November 1954.

[24] Rawls, John, *A Theory of Justice,* Oxford University Press, 1973.

[25] Buchanan, James M., *The Limits of Liberty: Between Anarchy and Leviathan,* University of Chicago Press, Chicago and London, 1975.

Discussion

LORD ROBBINS: We are grateful to Professor Rowley for his splendid conspectus of certain modes of approach to the problem we are to discuss today.

It would be interesting on some other occasion to discuss to what extent Professor Rowley would regard the outlook of early welfare economists, such as, to take the most conspicuous case of all, Pigou, as capable of being reconstructed so as to escape the strictures he has passed on those who have pushed too far, and perhaps with too much naïvety, the analysis which may or may not be implicit in such a system.

PROF. JACK WISEMAN: My question is in a sense technical but I was interested in Charles Rowley's comments on constructivism and Hayek's notion of synoptic delusion. Does not the same constructivism and synoptic delusion underly the common presentation of liberal competitive economic analysis, in that the notion of objective cost to be found there has in it either the Walrasian God or the Arrowian or Debreu God, precisely the Gods he has been trying to kill?

PROF. ROWLEY: I think we have to be clear what precisely we mean by the liberal approach. If we are talking about the sort of competitive market analysis of the Paretian type, then such discussion does suffer to a very large extent from constructivist rationalism in the sense that there are certain ends which are desired and a mechanistic means through which they can be obtained. This is not, I think, the tradition of Mill, or of Hayek or of the Austrian school in general. It is not the approach Alan Peacock and I developed in our book on welfare economics[1] where we were concerned much more with the means by which society governed itself, and particularly with an analysis of a mechanism which might be developed to enable individuals to be minimally restricted in order to be responsible for their own development, and not with trying to judge whether what they do is good or bad. In that sense liberalism is not essentially to be condemned for constructivist rationalism; but the Paretian approach certainly is.

LORD ROBBINS: This is an all-embracing condemnation. Was not some of the Paretian analysis elaborated to demonstrate the impossibility of the state of affairs contemplated, according to your paper, by Arrow?

PROF. ROWLEY: Arrow's analysis proves the 'impossibility' of establishing a constitution which can be guaranteed to satisfy a set of apparently desirable characteristics; but, as Professor Buchanan said (Part I, pp. 6-7), Arrow was disappointed by this result. Arrow would rather

[1] *Welfare Economics: A Liberal Restatement,* Martin Robertson, London, 1975.

have liked to be able to establish a constitution through which planning procedures *could* develop. I am concerned that the Arrow impossibility theorem has led a large number of economists to write literally dozens of papers in the theoretical literature designed to show how, by relaxing certain conditions, acceptable solutions *are* achievable. All of it is leading economists to an approach which is dependent on the existence of a large amount of knowledge, not merely on preference orderings but even on preference intensities.

CHRIS GOODRICH (*LSE Ph.D. student*): I would argue that this development is more a function of the economics profession itself, and that economists have grasped onto a new paradigm which will enable them to enhance their professional prospects, rather than investigating the philosophical underpinnings of the idea itself. I would also argue that Professor Rowley's attack upon the Arrow approach is more upon application than upon the problem itself. Where we are dealing with any democratic situation, where collective decisions are made upon the aggregation of individual preferences, then voting rules do count. The logical paradoxes pointed to by Arrow and his followers and by people who preceded him, such as Duncan Black, are therefore important, if you wish to adopt this view of democracy.

I also disagree with the attack upon the liberal paradox. The problem is more in the structure than in the paradox itself. If you allow a more realistic idea of a constitution within the logical structure, one which allows for restrictions on the domain of the collective decision or on the domain of the application of the constitution itself, then the problem of meddlesome preferences does not arise, as Campbell has shown in a paper several years ago.[2] If you take this view one stage further, and allow for non-homogeneous social states or non-homogeneous areas over which the collective decision is to apply, the problem also disappears, as Nath[3] has shown.

PROF. ROWLEY: I agree economists can benefit themselves by applying certain techniques and approaches in their favour. It has perhaps led to excessive applications in social choice economics. I also agree that the Arrow approach itself is not the fault but its handling by the economics profession. But I am a little wary of the sort of work done by Campbell. The domain of collective choice is the assembled profiles of all individual

[2] Donald E. Campbell, *Elements of a Constitution*, Working Paper Series No. 7303, Institute for the Quantitative Analysis of Social and Economic Policy, University of Toronto, November 1973.

[3] S. K. Nath, *An Alternative Scenario for the Theory of Social Choice*, Warwick Economic Research Paper 62, Dept. of Economics, University of Warwick, 1975.

preferences. If this domain is to be restricted, certain preferences will be ignored, and I do not think that is liberal.

To talk about the range of the functions is a different matter. If you want to restrict the range of the functions so that certain configurations of individual preferences are monitored to some extent, I am more with you. I think that there is something to be discussed along those lines. This is the kind of work Professor Buchanan is doing on constitutionalism.

PROF. J. E. MEADE: Let us say you cannot have a liberal state unless you make people liberal, and Paretian analysis is marvellous and really liberal people do not want to meddle. If you want to put things right, you must teach people to be liberal.

PROF. BUCHANAN: I think this whole discussion about meddlesome preferences is really a red herring, and I don't like the attack on the Paretian principle in Professor Rowley's paper. I think that the whole Sen discussion is really a sort of 'much ado about nothing' because there is no contradiction between liberalism and the Paretian principle. All that is required is, of course, that people be assigned rights. So initially the same paradox emerges only because he doesn't assign rights. If you assign people rights, and if they agree to give up their opportunities for sleeping on their belly or living in Newcastle in exchange with other people, which would be the Paretian principle, then that's fine.

It seems to me we are really talking about something we should not be talking about. It has been in the literature. Admittedly it is an important topic in terms of the number of pages printed in the literature, but it really should never have been brought up because there is no contradiction.

PROF. ROWLEY: Sugden has argued[4] that in certain instances the assignment of property rights may resolve the problem—that is true. If we take the case, for example, of *Lady Chatterley's Lover,* the book is presumed to be available either to one or to the other, or to nobody. Now supposing Mr A were to be assigned the right of ownership to the book. Liberals have got nothing to say about what one might call positive freedom, the effective power implicit in the allocation of rights. If those property rights were determined it would then be Mr A's decision whether or not he should read the book, and that supposition does seem to resolve the problem.

LORD ROBBINS: You mean physical ownership of the book, or ownership of the copyright?

PROF. ROWLEY: We think of it simply as one copy of a book.

PROF. WISEMAN: But there are no property rights in Sen.

[4] 'Social Choice and Individual Liberty', AUTE Proceedings, *op. cit.*

PROF. ROWLEY: Let me go further. Property rights are not assigned in the absence of a political mechanism, and, as we well know, they can be adjusted. Suppose that rights are allocated, but that Mr A and Mr B possess preference profiles which are 'meddlesome'. They will then adjust the property right in a meddlesome form. It is precisely that which is in dispute between Paretians and liberals.

To put it in the starkest possible way: If one half of this room were sadists and one half masochists and Pareto-preferred contracts of coercion were implemented, there is nothing in the Paretian approach to say there is anything wrong with such an outcome. It is a case of gains from trade and is beneficial. But to a liberal—an outsider obviously or else he could veto the contracts—such an outcome would be deplored.

MORRIS PERLMAN (*LSE*): I don't quite understand why Professor Buchanan has argued that there are no property rights in Sen's liberalism. Surely his definition of minimal liberalism is an assignment of particular property rights. If we assume that individual 'A' can sleep on his back or his belly, or can read or not read *Lady Chatterley's Lover*, that is an assignment of property rights. He does therefore assume minimum property rights, which is his definition. Otherwise he would not have minimal liberalism. Then the contradiction that he finds is, given that we had assigned those minimal property rights, there is a conflict with the Paretian criterion. But surely property rights are there.

PROF. BUCHANAN: I don't think that's right. When Sen talks about minimal liberalism, he tries to assign each person the right to at least one choice and he argues that is a contradiction. But what is involved is at least one choice, all other elements in the state of society or the state of the world being fixed, and that's a logical contradiction—to assign that to more than one person. So that is not a property right. A property right assignment would be to give you the right to sleep on your back or your belly, and simultaneously allow other people to have the right to do that with their own choices. That would not involve other states of the world being fixed.

PROF. WISEMAN: The right must be transactable. You cannot have a property right that cannot be transacted. That is the contradiction in Sen. People have rights but cannot trade them.

LORD ROBBINS: This is a very complex problem. The general conception of the function of property rights, as developed *par excellence* by Hume in the *Treatise* and in the *Enquiry*, relates, essentially, to the utility of somebody to take care of scarce resources. Now we are talking about rights in personal postures or rights conferred by government as regards the printing of books, which fall outside Hume's analysis.

PROF. D. MYDDELTON (*Cranfield Institute of Technology*): A very non-technical question: I would regard, over the past twenty years or so, as a prime example of government failure, the handling of the currency. Is there any reason to think a free market currency system would have failed nearly as badly as the government monopoly of currency seems to have failed?

LORD ROBBINS: By a free market system do you mean entirely free from exchange control?

PROF. MYDDELTON: Among other things, yes.

PROF. ROWLEY: There is a case for the view that government control over monetary policy is probably detrimental and that if one had followed some kind of monetary constitution of the kind, for example, that Milton Friedman would have endorsed, the British economy would be functioning a lot better than it is at the present time. Whether or not a completely free market in currency would or would not generate a better result is, I think, a difficult question to answer. It would depend on one's views about the way in which the money system would operate, the way in which banks would or would not fail, the prudence with which they develop their liabilities in terms of the cash base, and so on, the willingness of society to accept this kind of system. One must admit that the concept of a central bank and its role in the money market came about because traditionally free markets in currency had brought problems.

LORD ROBBINS: I would ask Professor Buchanan whether it was luck or cunning which brought it about that the districts of the Federal Reserve System are not co-terminus with voting areas.

PROF. BUCHANAN: Probably luck.

LORD ROBBINS: Extremely good luck!

PROF. GEORGE W. JONES (*LSE*): Could Professor Rowley clarify what his worry is about our present political and governmental arrangements? Is it that the majority gets its way and is interfering in a meddlesome fashion in the rights of minorities, or is it that minorities are getting their way—parties, legislators, bureaus—and are meddling in or restricting the rights of majorities?

PROF. ROWLEY: With a first-past-the-post system it is possible for a minority of votes registered to produce a majority of seats in the House. The present Government when it first came into office was a majority government. So, in that sense, the decisive voters may be fewer than a majority of the voting population. That is a worry, if there are configurations of voter groups which might be particularly meddlesome. So I am concerned that, from a voting point of view, in the first-past-the-post system, meddlesome minorities may dominate policy.

I would be equally worried if a meddlesome majority obtained control of the apparatus of government and particularly so because, even if the electorate itself is relatively non-meddlesome, there are other meddlesome features in representative government. You only have to assume that the bureaucrats and the producer pressure-groups are meddlesome. An element of meddlesomeness in both would almost certainly tilt policy into a meddlesome pattern, even if the majority of the electorate basically are non-meddlesome. The reason is that, with inadequate information, so difficult to interpret by politicians, they are very dependent on the producer groups and on the bureaucrats who supply and handle it. I am worried that the very nature of our representative system, with no constraints, no constitutional safeguards, will mean that even if society has a non-meddlesome majority, it may well end up with meddlesome policies. If there is a particularly meddlesome majority or a decisive meddlesome minority, then there is a serious danger to liberty.

2. Economics of Representative Democracy

ALBERT BRETON
University of Toronto

The Author

ALBERT BRETON: Professor of Political Economy, Institute for Policy Analysis, University of Toronto. Author of *Discriminatory Government Policies in Federal Countries,* 1967; *Economic Theory and Representative Government,* 1974.

ALBERT BRETON:

I. INTRODUCTION

It is fair to say, I believe, that most, if not all, modern research on what may be called the economics of politics has been done in the spirit of Keynes's following statement in the Introduction to the Cambridge Economic Handbook Series:

> 'The Theory of Economics . . . is a method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its processor to draw correct conclusions.'

I would only add that the methodology of neo-classical economics, based on the notion of a balancing of forces, usually associated with the concepts of supply and demand and with the idea of equilibrium, if systematically applied, helps 'to draw correct conclusions' in two different ways. First, it tells the investigator that certain forces or mechnisms must be present if other particular forces are operative: it is a guide to logical completeness. For example, if one assumes that governing political parties wish to be re-elected and sometimes act to guarantee that result, it is logically inconsistent not to search for the presence of individuals willing to extend or to withhold their support in exchange for something governing parties could give them.

Neo-classical economics 'a guide to internal consistency'

The second way neo-classical economics helps 'to draw correct conclusions' is by forcing the investigator to reject the presence of particular forces, mechanisms, or conclusions when certain other forces or mechanisms are operative: it is a guide to internal consistency. For example, if one assumes that governing parties can be re-elected only if they can satisfy the preferences of at least a simple majority of the electorate, one cannot also say that governing politicians always act to satisfy the preferences of producers and not those of consumers, unless one can also assume that producers constitute a large enough group to guarantee the governing parties' re-election. If one detects a tendency on the part of politicians towards producers' interests, any mechanism we imagine to explain that tendency will have to be consistent with the election rule (such as simple majority or proportionality) assumed, and consequently with the possibility that the preferences of some consumers, as well as those of producers, are sometimes satisfied.

At its most elementary, neo-classical economics tells us that systems which, as a first approximation, can be taken to be stable or viable respond to at least two separate sets of forces which combine together to produce determinate outcomes. Economists have labelled them supply and demand, and have studied their inter-relationship as mechanisms that lead to equilibrium outcomes. The remainder of this paper will therefore follow that order. The next Section is devoted to supply and the one following to demand; Section 4 defines the 'output' of governments, the goods and services they produce, while Section 5 examines one possible mechanism establishing equilibrium. Section 6 concludes the paper with a warning about political power.

II. SUPPLY[1]

Governments are the organisations that make up the supply side of the public sector. I simplify by assuming that only one government exists. I will not distinguish in this paper between politicians and the political party of which they are members. Not doing so can be justified either by supposing that the politicians of a given party have identical preferences,[2] or, as I prefer to do, by supposing that a log-rolling or trade-in-kind mechanism exists that allows politicians to swap support for ideas or Bills and so generate collective or party preferences.[3]

Governing politicians and bureaucrats maximise power. It is best to think of power as if it were a kind of capital which can be augmented or reduced. In terms of neo-classical theory, the kind of capital most resembling political power is 'good will'. More precisely, we can define a number, which I will call the critical value of the probability of re-election,[4] which tells us what the current value of

[1] The work summarised in this section is part of research in progress carried out jointly with Ronald Wintrobe of the University of Western Ontario.

[2] A. Downs, *An Economic Theory of Democracy*, Harper & Row, New York, 1957, pp. 24-25.

[3] A. Breton, *The Economic Theory of Representative Government*, Aldine Publishing, Chicago, 1974, pp. 124-30.

[4] That critical value is determined by constitutional and institutional factors, such as the election rules and the length of the election period. (Breton, *ibid.*, Ch. 3.)

that same probability must be if the governing party is not to be defeated at the polls. With simple majority, the critical value of the probability of re-election is 50 per cent of the electorate plus 1 person; if the current value of the probability is 49 per cent, the governing party will be defeated, but if it is 54 per cent, not only will it be re-elected, but, more important for our purpose, it will be said to possess political power in an amount equal to (approximately) 4 per cent.

Sources and uses of political power

The ways and means of accumulating power are not the same as those of decumulating it. There is, in other words, a basic asymmetry between the *sources* and the *uses* of political power. To accumulate power, governments must raise the current value of the probability of re-election relative to the critical value of that variable: this is done by supplying public policies that at least some citizens signal they desire.

There are two alternative channels through which power can be reduced or used up. First, governments can make mistakes which reduce the current value of the probability of re-election and hence reduce the stock of power. Secondly, power can be used up by implementing policies, such as pension schemes for civil servants, which no citizen wants, but which bureaucrats seek for themselves in a private capacity as bureaucrats. In that last case, power is given up to acquire policies (goods and services) from which bureaucrats themselves derive satisfaction.

In the same way, politicians may wish for themselves the implementation of public policies which will give them an exalted place in history even if it loses them votes today. They may seek policies which permit them to increase their personal wealth or which will satisfy a personal belief or a personal preference. The class of these policies, I need not emphasise, is very large; the few examples above should indicate its particular composition. A common characteristic of all of these policies is that they are costly in terms of the current value of the probability of re-election, that is, in terms of power.

Politicians and bureaucrats are co-operant factors

Earlier, I noted that politicians and bureaucrats seek to maximise power. It must now be recognised that politicians and bureaucrats are also 'complementary' factors of production, which implies that the production of public policies depends on their joint contribution. In addition, they are engaged in the production of a continuous and recurrent flow of public policies and consequently are led to co-operate with each other. In other words, bureaucrats and politicians are complements; that they continuously interact induces them to co-operate in the production of public policies, because that co-operation permits the implementation of a larger number of the kind of public policies which leads to a maximum of their own personal welfare.

The inducement to co-operation is real, but no less real is the fact that the stock of power thus accumulated must be divided between them. I indicate how this division is effected in Section 5. It is sufficient here to note that there are forces at work in the public sector which may lead to each party receiving the value of his or her marginal product, that is, the value of their contribution to increments or changes in policies, where that product is measured in terms of increments in power.

III. DEMAND

On the demand side of the public sector are citizens. In the model, these are not necessarily the same individuals as those who, in common parlance, we call citizens. Included, of course, are all the individuals of a political unit who have been enfranchised, but also any other individual, even if he is not under the authority of the government of that political unit—such as the so-called 'China lobby' in Washington, or the 'Rhodesia lobby' in London—who seeks by one means or another to influence the decision of that government. In this paper, I will not explicitly consider 'corporate citizens', that is, groups of citizens, like trade unions or professional associations, acting as units in the pursuit of interests which may be different from the interests of group members taken individually. Consequently, any individual who seeks to influence the decision of a particular government is a citizen from the point of view of that government whether or not he be a legally recognised citizen of that country.

Citizens, I assume, can be characterised by welfare indices defined over market goods and services and over governmental public policies. These citizens act in such a way as to maximise these welfare indices. In market goods and services this is done by engaging in direct purchases and sales of these goods and services in the market; in public policies, it is not possible for citizens to buy or sell policies directly, since suppliers are representative governments. Consequently, citizens can only signal their preferences to their government through the use of one instrument or another, and if these signals are heeded, there will arise a surrogate or imaginary exchange in which citizens will either vote for, transfer market goods or services (such as donations) to, and/or allocate time and possibly other resources (such as money or call girls) to, governing politicians and the governing party in exchange for the desired policies.

Citizens' political instruments

One could devote considerable space to the various instruments that citizens have access to, but it will suffice if I limit myself to listing a few for the sake of illustration. Citizens can do such things as participate in the activities of lobbies or pressure groups, sign petitions, join social and political movements, offer bribes, and extend or withhold support from the governing party to signal their preferences for public policies. In using these instruments citizens will be limited by the technology or internal structure of the instruments as well as by the time and money costs of that use. These constraints are additional to the income constraints which limit the quantity and quality of market goods and of public policies which can be 'acquired' by any individual or by any group of citizens.

As always in economics—and for that matter in all the social sciences—individuals, and therefore citizens, are induced to act, in the present context, to signal their preferences, either because they are in a state of disequilibrium, or because they anticipate being placed in such a state. To be more precise, if the benefits, measured in utility, from moving to an equilibrium position (defined by economists as the equality of the relevant marginal rates of substitution with the appropriate ratio of prices and costs) exceed the costs of such a move, citizens will use the instruments at their disposal and seek to effect the move.

IV. GOVERNMENTAL POLICIES

I begin by the following definition: the public sector produces nothing but public policies; or, alternatively, all the outputs of the public sector are public policies. In other words, whether we are considering laws, executive orders, statutes, decrees, ordinances, orders-in-council, rules or any other kind of command pertaining to the expenditure or to the collection of money, to the regulation of persons or of institutions, all are public policies by definition.

Governments therefore are seen to be organisations analogous to business firms producing a flow of public policies per time-period. The meaning that attaches to the word 'production' must be emphasised. We must refrain from thinking of the production of public policies in terms of *parliamentary* proceedings only. Of course, these have a role to play, but we must think of the production of policies as also involving the continuous and recurrent *administrative* tasks that are part of the day-to-day implementation of these policies.

Production of public policies—an illustration: tariffs

Let me illustrate this point with reference to tariffs on imports. The production of tariffs or of a tariff structure entails introductory discussions by private interests with bureaucrats and politicians, followed by the preparation of preliminary documents, executive or cabinet decisions, the drafting of bills, the deliberation of parliament, and the implementation into law. But production activity does not end there. Indeed, as long as the tariff structure is in effect, governing politicians and bureaucrats will be involved in the daily implementation of the law: they will be involved, that is, in interpreting the law, in deciding on the extent of its application, in deciding on special cases, in defining exceptions, and so on. It is this entire set of operations which is encapsulated in the words 'production of public policies', and it is in that production that politicians and bureaucrats co-operate on a continuous basis.

Public policies, however, are not homogeneous. There are consequently many ways of classifying them depending on the problem that must be analysed. For my purposes, the following system of classification will be the most useful. Imagine that each policy is essentially an aggregation of characteristics in the same way that economists have recently conceived of market goods to be bundles of characteristics.[5] These characteristics, it must be emphasised, are not subjective, but objective, measurable dimensions of policies: it is,

[5] K. J. Lancaster, 'A New Approach to Consumer Theory', *Journal of Political Economy*, April 1966, pp. 132-57.

in principle, possible to observe them and it is possible to define an ordering of preferences over them.

Three classes of characteristics—and a 'dominant role'

For my purposes, I distinguish between three broad classes of characteristics according to whether they are likely to satisfy the preferences of citizens, of politicians and of bureaucrats. Implicit in such a classificatory scheme is the notion that, when engaged in public sector activities, these individuals can be characterised by a dominant role. Bureaucrats, for example, are more concerned for their personal welfare as bureaucrats than for their satisfaction as citizens.

To understand the nature of the classification scheme proposed, it will be useful to illustrate, instead of giving abstract definitions. Consider, again, the case of tariffs on imports. This public policy has many characteristics, some of which are well-known, others less so. I give a short list, which some readers may wish to expand. Tariffs:

(i) raise the price of foreign goods and of domestic substitutes;
(ii) make some domestic producers competitive in local markets;
(iii) may raise the earnings of labour in the protected sector;
(iv) redistribute income in favour of certain groups;
(v) make it easier for the inefficient and the mediocre to thrive;
(vi) may permit the support of a larger total population;
(vii) will usually stimulate domestic investment in the protected industry;
(viii) add to public revenues;
(ix) require the creation of jobs in the public sector;
(x) give discretionary power to senior bureaucrats who have to administer the tariff structure;
(xi) make it possible discreetly to reward friends and punish foes either by a change in the tariff rate, in the tariff list or in the mode of administration of the tariff law; and
(xii) must be co-ordinated with the tariff structure of other countries and therefore necessitate international contacts and travel abroad, with all the amenities that such travel necessarily entails.

As indicated, this is a short list which could easily be expanded. A similar list could be compiled for all possible public policies without much difficulty, though it would seem impossible to provide an exhaustive list of all the characteristics of any one policy. What must be noted is that some characteristics—in the list above, those numbered from (i) to (v)—are likely to be more preferred by citizens, others—those from (vi) to (viii)—will be more preferred by politicians, and others still—those from (ix) to (xii)—are likely to be more attractive to bureaucrats.

It is not, of course, necessary that the three classes of characteristics be mutually exclusive; it is indeed quite possible that some characteristics could appeal to all three groups of individuals at once, or to any two of them. Such a situation would not imply that characteristics are equally valued, in terms of utility, by all participants.

V. AN EQUILIBRIUM MECHANISM

We are now in the position to bring the various building-blocks together, to outline how the system works to establish an equilibrium, and to describe some of the properties of that equilibrium.

The first thing to emphasise is that the provision of some bundles of public policies to the citizenry will yield a higher probability of re-election for the governing party and consequently will increase the stock of power at its disposal. But the governing party cannot decide alone which bundle of policies it will supply, since the bureaucrats are complements to politicians and have independent preferences for public policies. Their preferences are of two kinds:

(i) between the alternative bundles of policies that increase total power, they will prefer the ones in which their share of power (i.e., their marginal product) is the largest, and

(ii) between the alternative bundles of policies on which they can 'spend' that marginal product, they will prefer those that yield the highest utility to themselves.

There are therefore two inter-dependent problems: (1) to choose the basket of public policies that will make political power as large as possible for politicians and bureaucrats together; and (2) to guarantee that the policy bundle gives all politicians and bureaucrats the value of their marginal product in the form they desire, i.e. measured in terms of the value of characteristics of public policies desired by them.

Before outlining the nature of the solution to these two problems, it is essential to bear in mind that it will involve citizens in a fundamental way; indeed, the value of the probability-of-re-election variable can be altered only by the effect of policies on citizens, so that selecting a bundle of policies that resolves the two problems is like finding an equilibrium solution to a supply and demand problem.

Kinds of competition among bureaucrats

It will be useful to an understanding of the properties of the basic solution to note the kinds of competition that go on in the public sector. Let us begin with the bureaucrats. These compete on two fronts: first, they have views about which party should be in office, views which depend on their estimate of the marginal value of their contribution in the production of power with each party; they will therefore co-operate with the governing party in producing policies as long as they believe that the value of their marginal product is higher with that party. The second front on which bureaucrats compete is with each other, and that is because there are severe limitations in resources and time on the number of new public policies and of revisions to old policies that can be introduced during a specific legislative period.

The constraints originate in the fact that any increase in the flow of resources which can be used by politicians and bureaucrats to produce policies implies increases either in taxation or in the other modes of command over privately produced output, increases which always lead to a fall in the value of the probability-of-re-election variable. They also arise because deciding on new policies uses up valuable time of executive and legislative bodies, of which there is a limited amount.

The existence of these constraints implies that bureaucrats will compete with each other for what may be called the attention of both governing and opposition politicians. What will be the nature of that competition? Simply, they will be led to recommend the implementation of policies which possess fewer of the characteristics that yield utility to them as bureaucrats. In other words, in trying to get governing politicians to implement the policies they prefer or in seeking to extract an implementation, bureaucrats will bid against each other by demanding fewer or less valuable characteristics from the class of characteristics they prefer.

One of the implications of the above argument, which can be noted immediately, is that some bureaucrats will maintain contacts with opposition, and not only with governing, politicians, and that they will sometimes seek to promote the electoral fortunes of some opposition politicians. Furthermore, bureaucrats, though they may be co-operating with governing politicians, are always engaged in a competitive struggle which involves both opposition politicians and other bureaus and consequently cannot lose sight of their own interest in that co-operation. One is inclined to think that the often repeated view that bureaucrats are not partisans in 'serving the public', but are strictly neutral, stems from the understanding that a too-deep involvement with governing politicians is against their interest and could eventually spell their destruction.

Kinds of competition among politicians

But competition in the public sector does not end there. Political parties are also engaged in a two-front competitive struggle. First, they compete for the support of the electorate. This is achieved by proposing and implementing policies with characteristics desired by citizens. The competition involves bidding-down the number or the value of the characteristics desired by politicians and thus increasing those preferred by citizens. Second, they also compete for the co-operation of bureaucrats. This is the reverse phenomenon of the competition of bureaucrats for the attention of politicians.

This three-way competition, if it were 'perfect' (a term defined below), would lead to a situation in which the utility of citizens would be maximised, in which politicians and bureaucrats would divide power according to the marginal contribution of each, and in which the disposal of power by politicians and bureaucrats would maximise their own utility, as in any competitive market.

It would be beyond the scope of a short paper to examine in detail what 'perfect competition' in the public sector should mean. It is important, however, to be certain to define it in a way that does not remove the existence of representation and of representative government. In other words, it cannot be defined in such a way that, in equilibrium, political power always vanishes. That might be an interesting logical exercise, but it would deny that political institutions such as those characteristic of representative democracy are needed in the first place. This is why a thorough and systematic analysis of the 'constitutional problem', which has retained the attention, in recent years, of such scholars as Buchanan and Tullock, Rawls, and Nozick, is so important.[6] Indeed, without some prior agreement on what determines an 'optimal' constitution, it is virtually impossible to know how far the real world of politics departs from some notion of 'perfect competition'.

This statement does not imply that predictive exercises must await an elaboration of, and an agreement on, a 'theory of constitutions'. The search for an understanding of the consequence of a departure from perfect competition in the public sector can go on without prior knowledge of the exact real-world configuration of perfect competition. I will not undertake such exercises in this paper because of a lack of space. The presence of imperfect competition in the public sector must, however, be kept in mind in interpreting the above conclusions. Indeed, the main challenge ahead would seem to be the formulation of a theory about the nature of imperfections in competition as it exists in the public sector.

VI. CONCLUSION

In this paper I have tried to show that the approach and the methods of neo-classical economics can be applied to problems which have traditionally been taken to be outside the set of phenomena to which economics has been applied. In particular, I have endeavoured to show that the balancing of forces, usually associated with supply and demand and with equilibrium analysis, which is so central to neo-classical theory, could be applied to the public sector.

In conclusion, I should point out that the above approach does not imply that economic and political activities are pre-ordained. I noted earlier that even if something like perfect competition characterised the public sector, representative government would still exist and hence power would still be central to political life. It is in the

---

[6] J. M. Buchanan and G. Tullock, *The Calculus of Consent*, University of Michigan Press, Ann Arbor, 1962; J. Rawls, *A Theory of Justice*, Belknap Press, Cambridge, Mass., 1971; R. Nozick, *Anarchy, State and Utopia*, Basic Books, New York, 1974; J. M. Buchanan, *The Limits of Liberty: Between Anarchy and Leviathan*, University of Chicago Press, Chicago, 1975. Also H. S. Gordon, 'The New Contractarians', *Journal of Political Economy*, June 1976, pp. 573-90.

existence of the power politicians and bureaucrats have at their disposal that the possibility for discretion which either improves or worsens the lot of men and women can be felt. The world is not more pre-determined because it can be analysed with the tools of neo-classical economics!

Discussion

PROF. BRIAN LOASBY (*University of Stirling*): The analysis we have just heard used the full neo-classical apparatus, but it was emphasised that, in equilibrium of the political system, political power continues to exist. The corresponding market equilibrium assumes that entrepreneurial power does not exist. Could we have some comment on the adequacy of putting these two different views of equilibrium together?

PROF. BRETON: One can certainly formulate neo-classical economic theory in such a way that, in full equilibrium, given specificity in factors of production, quasi-rents will remain even in full equilibrium. These quasi-rents would not be very different from the political power I have in mind. Indeed, if one wanted to translate the political model into a model of the theory of the marketing of private goods and services, one would say that entrepreneurs do not maximise profits, but excess profits or quasi-rents, which the competitive outcome, without specificity of any kind, would eliminate. So I see representative governments as institutions whose equilibrium is characterised by the existence of political power, just as I see the competitive equilibrium characterised by quasi-rents in the presence of specific qualities in factors of production.

PROF. MARK BLAUG (*University of London*): I cannot understand the force of defining political power as the difference between 50 per cent plus 1 of the votes and whatever percentage a political party obtains in excess of that, so that, if a political party is elected just by a majority of 50 per cent plus 1 person, power is zero. I would have thought such a political party could still put some bundle of policies into practice—the essence of political power. Why does Professor Breton define political power in such a way that, in practice, it vanishes when the party is elected by one vote?

PROF. BRETON: The justification is simply that it is hard to conceive of anyone wanting to enter politics for the sole purpose of satisfying the preferences of citizens. In other words, if the system operated in such a way that, according to the definition I use, political power was always zero, politicians could not pursue other objectives than doing what citizens desire, otherwise they would be defeated. Only if they believe that they will be able to shape the destinies of collectivities, or pursue their vision of the common good, or enrich themselves, or seek some other *private* goal, could individuals be induced to enter politics. One needs a definition of power that can accommodate this reality. Also, note that many who enter politics do so at some sacrifice in money income. They are striving for something else than solely providing the electorate with what it wants.

LORD ROBBINS: Would you claim, Professor Breton, that your system of analysis has predictive value?

PROF. BRETON: I think it has, yes. I think that one can apply the analysis to the political business cycle, for example, which Bruno Frey is going to talk about. Or one could apply it to the problem of whether bureaucrats seek larger bureaus or not. If larger bureaus are conducive to more power, then they would, but if larger bureaus do not lead to more power they would not.

I have not made predictions in my paper because of space limitations. To make more predictions one would have to do additional work on what I have called here the problems of imperfect competition; in particular the problem of the asymmetry in competition between governing and opposition parties. Opposition parties are not in the same position as governing parties to affect the current value of the probability of re-election. Consequently, in the public sector, competition is always imperfect or asymmetric. In my earlier book, as a number of people have pointed out, I did not analyse the relationship between bureaucrats and politicians; that is what I am trying to do now.

PROF. J. E. MEADE: In this analogy between the competitive market system and the production of government policies, one element should be brought in. The old-fashioned competitive market analysis with its welfare implications rests upon the assumption that consumers have preferences and producers have technical possibilities of production. In practice, the producers mould, to some extent, the preference orderings of the consumers. Advertising is the biggest example, but there is more than advertising. Do you take the pre- or the post-indifference patterns of the consumers as the ones that should be satisfied? Before or after the advertising campaign, or whatever it is?

What has so far been left out this morning is that politicians above all try to mould the preferences of the electorate. I am an old-fashioned do-gooder and I think that some politicians are old-fashioned do-gooders. They want people to have certain preferences in public policies, rather than others. I think some bureaucrats even are do-gooders. This element of trying to mould the preferences of the voters, just as producers mould the preferences of consumers is, I think, of immense importance.

RT. HON. JO GRIMOND: I think Professor Meade is quite right. I am amazed by the altruistic outlook of many of my colleagues and, indeed, of bureaucrats. I understand that Professor Breton allows for it, but I am not sure that he puts sufficient emphasis on it. There is no doubt that if parties had no beliefs, they would react quite differently. There is some evidence that budgets are trimmed for electoral purposes, but in many ways they are not. It is astonishing, I think, how little bribery is carried out by the Chancellor of the Exchequer. If you examine political decisions, a lot of them, I think, could come only from personal beliefs. Many Members of Parliament don't want power. I don't think, for instance, Mr Sidney Silverman ever wanted to be a member of the Government; I don't think he was in politics for anything else but to express and pursue rather eccentric, very left-wing views. I am not saying this is right or wrong, but I am not certain how he comes into the free-market equation.

Professor Breton seems to me to have left out, no doubt deliberately, the attention paid by politicians and political parties to organisations other than bureaucrats and voters. As well as bureaucrats and voters, the Labour Party has to pay a lot of attention to the trade unions, even though they may be very unpopular. I am not certain how they come into the supply and demand analysis. Again, the Press receives very close parliamentarian attention. I am not certain where it comes in.

At election times, politicians present a package, out of which upright, altruistic men like Professor Meade select one or two items they think highly desirable; and they probably weigh up the total desirability of the package as well. But the Professor Meades are in the minority. The vast majority of the British vote *against* a package. If you don't like one brand of politics you 'buy' another. This is not how the market works: you just avoid the brand you don't like. In politics you actively go and buy another brand. I don't quite see how that difference fits into the market analysis.

As for particular policies, Jock Bruce-Gardyne[1] wrote a very interesting book[2] analysing how four particular decisions were reached by government, not by politicians. I don't think one can lay down any general lesson from them. I don't think there is a market. The decisions examined in that book—to go into the Common Market, to abolish resale price maintenance, and so forth—came out of a different package of motives, and I think it will be very difficult to say there was any attempt to maximise political power or even to use political power. The voters on particular packages undoubtedly have some effect, but it would be very difficult to

[1] In the audience: p. 113.

[2] *The Power Game*, Macmillan, London, 1976.

analyse that effect. In economics, if you have increased demand, it eventually calls forth increased supply. I am not aware that that happens in politics. On the contrary, I am inclined to think that if the public begins to demand too much of various things, ultimately the process has to be stopped, because there is no means to increase the supply.

PROF. BRETON: The points raised by Mr Grimond and by Professor Meade about the adequacy of the economic analysis of politics can all be raised about the economic analysis of markets. If one undertakes a detailed description of the production of shoes, from the purchase of inputs by all the firms in the industry, to the way they are combined together by the use of machines and labour, to the way each entrepreneur engages in the marketing and sale of these commodities, one can be rapidly led to the view that the theory of supply and the theory of the firm do not apply, because what is particular to each activity and to each firm seems so important as to lead to the view that the general model does not apply. It is always possible to widen the gap between reality and theory! So I'm never too worried about first appearances—the differences between what the theory says and what individual case studies say. Case studies shed a particular light on the real world different from that of theory, and the knowledge derived from them can be put to a different use than the knowledge derived from applying theory.

Another problem of neo-classical theory is that it cannot tell us which new commodities are going to be put on the market. They do not seem to originate on the demand side of the market, though the theory tells us that supply responds to demand. It is difficult to imagine that consumers as a group would be able to come up with the notion that they need a new kind of electronic device to capture hitherto unknown sounds. It is entrepreneurs who put such devices on the market, then they are tested and rejected or accepted by consumers. Only after that does the role of demand become important. It is difficult to model that phenomenon. Everything that has to do with preferences and with changes in preferences is difficult to model, but it is not more difficult in the analysis of the public sector than in the analysis of private markets. Whether the difficulty in modelling the phenomenon is more serious or harmful to the public sector than to the private market analysis is an open question about which I have no strong views.

RICHARD LAMB: I am a journalist, not an academic. I was fascinated by the way Professor Breton brought in the example of import tariffs as part of his argument on how citizens can signal their choices or preferences for public policies. If you consider what has happened in the United Kingdom, his argument seems to fall to the ground. We became a protectionist country in 1932 and have been one ever since. We incorporated the McKenna duties from the First World War in 1932 and put on other duties; they stayed with us for forty years and only began to disappear when we joined the Common Market. The consumers suffered very severely, as Professor Breton hinted, but there was no way at all that they could get them altered. In the 1932 Act, for example, there was a reasonable process for reducing duties, but that was destroyed by the Labour Government just after the war and we were completely locked in with these out-of-date duties until a few years ago. The consumers were not able to exercise any choice there, because of the power of the trade unions and the Federation of British Industry. Those are the factors which leave us locked in to the import duties.

I am sure we shall not get rid of the common external tariff of the Common Market, nor the Common Market Agricultural Policy, no matter how strongly the consumers feel about it, because of the other vested interests. The import duties' example rather questions Professor Breton's argument instead of supporting it.

PROF. TOM WILSON (*University of Glasgow*): Professor Breton talked about people expressing preferences on the one hand through the market and on the other hand through the voting system for public policies. One can very easily exaggerate the rationalism that is displayed in both cases and certainly very easily exaggerate the scope, as has been said, for choosing between public policies if you have an intelligent and acceptable package. I want to stress something rather different.

One of the outstanding problems is that people behave inconsistently in these two roles: that what is expressed in a market is inconsistent with what is expressed at the polls. You find very important political problems, certainly in this country, with this schizophrenia. I think that is important and I would like to hear his views.

PROF. BRETON: I do not disagree that citizens have a limited number of instruments to signal their preferences. But voting is only one tool used by people to signal their preferences in the public sector. Public activities go on all the time. People do not just register preferences every four or five years. Contacts between citizens and politicians, pressure groups, lobbies, networks, advisers, polls, etc., are all used to discover the preferences of citizens. The problem raised by Professor Meade of changing preferences and of forming new ones is closely connected to the process of preference revelation in politics and, as I have indicated, this is very difficult to model.

On altruism in the public sector, the problem is not whether it exists or not, but why it is stronger at some periods than at others, and why it sometimes completely dominates the pursuit of self-interest while at other times it seems to play virtually no role. The old notion that politicians and bureaucrats are dedicated to the common good that is unrelated to their own interest is not a good ground on which to build a theory of the working of politics.

LORD ROBBINS: Fascinating as are the questions which Professor Breton raised, if time permitted I should have liked myself to ask him what he considered to be the role of case studies. I am a Popperian in this respect, and I do not believe that any number of case studies can establish an invariable rule; but I do believe that case studies can *falsify* theories and I suggest that some case studies might falsify some theories of bureaucracy.

3. The Political Economy of Nationalised Industry*

JACK WISEMAN
University of York

* This paper has benefited from discussion with members of the Public Sector Studies Group at the University of York, and from the programme support provided by the Social Science Research Council. The latter included support for a study of industrial subsidisation, of which the present paper is an actual, if unexpected, output.

The Author

JACK WISEMAN: Professor of Applied Economics and Director of the Institute of Social and Economic Research, University of York, since 1964. Formerly Lecturer and Reader at the LSE, 1949-63. He is Joint Editor of University of York Studies in Economics, and a member of the Editorial Board of the *Journal of Public Finance*. Author (with Professor A. T. Peacock) of *The Growth of Public Expenditure in the United Kingdom* (1961, 2nd edn. 1967); (with Professor E. H. Phelps Brown) *A Course in Applied Economics* (1964, 2nd edn. 1966).

Professor Wiseman is a member of the IEA's Advisory Council. For the IEA he has written: (with Alan Peacock) *Education for Democrats*, Hobart Paper 25, 1964 (second impression 1970); 'Growing without Nationalisation', in *Growth Through Industry*, IEA Readings No. 2, 1967; and 'A Model of Inflation and the Government Deficit', in *The Dilemmas of Government Expenditure*, IEA Readings No. 15, 1976.

JACK WISEMAN:

I. INTRODUCTION

Nationalisation in the UK provides a useful test-bed for ideas concerning the relations between economics, politics, government and bureaucracy, because of the manifest gaps between reality and belief observable in the debate about nationalisation policy: because, that is, of the strength of myth in this area of public debate. Myth significantly affects the behaviour of nationalised corporations, the rules by which the behaviour is supposed to be governed, the interpretation of the outcome of that behaviour, and the consequent political attitudes to the corporations and their future governance.

It may seem strange to hear an economist talking about myths. But we are concerned to explain human behaviour, and if the way the community's resources are allocated between uses is significantly affected by myths, then myths are what we need to talk about: the more so if the relevant mythology is at least partly shared by all political parties, although some politicians do not know, or act as though they do not know, that the mythology exists.

I do not claim that the concepts I use are novel, but I think that perhaps their application to nationalisation may give some of you a rather different view of the relevant policy problems, which is my prime purpose. Also, I shall concentrate my illustrative material on the situation before Cmnd. 7131, *The Nationalised Industries* (March 1978). This new policy document was published when my paper was almost completed. Its contents in fact fit well with my general theme, as I shall try to show in a Postscript.

II. THE ECONOMIC EFFICIENCY MYTH

The most pervasive, and probably the most damaging, myth is that industries are nationalised in the interests of economic efficiency, to overcome the defects or incompetences of provision of the goods concerned through private markets. Since the diversity of products and historical circumstances within the existing nationalised sector makes this notion difficult to swallow save for the truly credulous or blinkered, the same notion also appears in a rather more sophisticated form: whatever the 'special circumstances' that in practice lead to a set of activities being nationalised, the *result* of nationalisation will be an improvement in 'economic efficiency'.

Economic efficiency and nationalised industry

Economic efficiency is not a simple notion. It is indeed difficult in a paper as short as this to give a summary exposition of the debate on this question during the post-1945 era of nationalisation. In the early part of this period the debate about the organisation of nationalised industries was dominated by specialists in public administration, mostly sympathetic, and by politicians of left-wing views. The interests of consumers did not figure prominently in these debates: they could be left to well-meaning administrators, provided that suitable organisational arrangements had been created.[1] Nevertheless, the underlying, if implicit, notions of efficiency were essentially those of the competitive market economy—what economists like to call the 'Pareto-optimal' conditions, or, in everyday language, the direction of resources towards the uses in which consumers most want them. The most formal espousal of this perception of efficiency is to be found in the 1967 White Paper, Cmnd. 3437, *Nationalised Industries: a review of economic and financial objectives*, which effectively required that nationalised industry products should be sold at prices equal to their long-run marginal cost. I have argued elsewhere [2] [3] that the practical relevance of this prescription is of the same order as would be an injunction to price according to the principle that God is Love: the sentiment is difficult to deny, the practical consequences of conformity unidentifiable.

Events since the publication of the 1967 *White Paper* have given me no reason to change my views. But my immediate pre-occupation is different. Without bothering you with an undue amount of technical exposition, I will simply assert that the essential reason for promulgation of the long-run marginal cost 'rule' was that its use was expected to lead to the same (resource-allocation) outcome as would an efficiently functioning system of competitive markets. That the underlying economic analysis is wrong, or, rather, irrelevant to the real-world situation, is not immediately to the point. What matters to me here is that the policy-makers' notion of economic efficiency for the nationalised sector was essentially the same as the efficiency notion customarily applied to the private market economy.

[1] A useful survey is in Chester [1].

Three arguments for nationalisation

In this scenario, nationalisation is simply a device, to be judged by its results. It is needed because provision through private markets fails to 'deliver the goods', and it is to be judged by its success in remedying the relevant defects. Thus, arguments for nationalisation concern, for example, the need to deal with the problems of 'natural monopoly' to provide 'public goods', or to give the government authority over the 'commanding heights' of the economy.

(i) *Natural monopoly*

None of these arguments emerges particularly well from a confrontation with the facts. The 'natural monopoly' argument derives from the proposition that atomistic competition is not possible in the industry concerned because of the existence of economies of scale: competition is destroyed by technology. But in which UK nationalised industry is the minimum size of a technically efficient *plant* so large that competitive production is impossible *for this reason*? The relevant consideration is clearly not the minimum size of the necessary investment, but the relation between the output appropriate to that size and the size of market demand. Would the coal industry, for example, qualify on these terms? Surely not. At best, there is the possibility that, for some goods (such as electricity), the relevant indivisibility lies in *distribution* rather than in production arrangements. But this is essentially a matter of property rights (of which more later). If the contractual relationships between the 'grid' and the 'producers' is appropriately specified, there is no *technical* reason why the generation of electricity, for example, should not be competitive.

(ii) '*Public goods*'

The essence of the 'public goods' argument is that certain goods will be under-supplied if provision is left to market forces, because their consumption is 'non-excludable': we all 'share' the same level of defence expenditure. For the UK, the argument has two major deficiencies. First, a problem of principle: it is very difficult to imagine a good whose consumption could not be 'rationed' by price if the community chose to pass appropriate laws and require producers and consumers to carry the appropriate costs. Again, the problem is ultimately one of defining property rights in such a fashion that the relevant exchange transactions become possible. Nationalisation *per se* does not solve this kind of problem: the criteria determining how much of the good concerned should be produced and the price at which it should be sold remain to be specified. (The provision of lighthouses, often cited as an example of a public good, provides a useful exemplar. Devices exist by which the receipt of warning signals could be restricted to vessels which have paid for and installed appropriate equipment. That such devices are not used is attributable not to any *inherent* peculiarity in the nature of the product, but *either* to the costs of creating the necessary market *or* to the concern of the community for the welfare of sea-going travellers (i.e. to interpersonal utility relationships).

(iii) *'Commanding heights'*

The 'commanding heights' argument is even more nebulous. Its essence is the proposition that, through nationalisation, the government acquires economic policy 'tools' that it would not otherwise have. But this suggests that industries can be classified as 'appropriate' for nationalisation, or not, by reference to the 'commanding heights' notion. However, no useful taxonomy has ever been proposed, and it would defy reason to suggest that the industries actually nationalised in the UK enjoy this status because of their role as part of the 'commanding heights'. Many of them are more clearly part of the abysmal depths of UK economic performance than of the commanding heights of UK economic policy.

Nationalised industry decisions in practice

Whatever the plausibility of these technical arguments for nationalisation, it is clear that they are of secondary relevance for the way decisions on the allocation of resources are taken in practice.[2] Conformity with the long-run marginal cost 'rule' does not seem ever to have been more than a formal matter: how to present 'commercial' plans in an 'acceptable' fashion. Levels of subsidisation have been historically determined, and have not generally been related to notions of 'publicness', or to identifiable community benefits not reflected in costs and prices. The industries have been protected from private competition, which would seem to be in contradiction of the

---

[2] R.H.S.Crossman quotes Mr James Callaghan (then Chancellor of the Exchequer) as follows on the 1967 White Paper: 'You, Crossman, are a don who knows nothing about the subject. Personally as Chancellor I couldn't care less. I take no responsibility and I took no part in composing it.' See also Foster [4].

efficiency concept concerned, unwanted resources have not been made freely available to other potential users at 'scarcity' prices, and no 'liquidation' rules similar to those of bankruptcy in the private sector have ever been promulgated.

Finally, even if planning by the nationalised industries themselves had been developed in consonance with some common notion of efficiency for private and public sectors, the actual outcome would have been changed by Ministerial interference, e.g. in such matters as pricing and wage-bargaining. By stretching a point, such interference might be argued to conduce to efficiency in our defined sense, as being governed by the 'commanding heights' approach to global economic policy. But there is no way of knowing, since inadequate information about Ministerial intervention is made public, and practically no information is available on the predicted *consequences* for nationalised industries of Ministerial changes in management policies.

III. THE POLITICS MYTHS

My separation of economics and politics is no more than a taxonomic convenience: the politics myths, of course, march with the economics ones. There are two sets of politics myths that concern us.

First, the myths about property. One reason for nationalisation would be a moral objection to private property in the means of production—'property is theft'. It would be difficult to use this argument to explain the piecemeal nationalisations which have produced the UK mixed economy. If it is private property *per se* that is morally objectionable, why nationalise only this particular set? Perhaps this is the reason why the argument of principle has not been more prominent in public debate. The myth, established by default rather than positively asserted, is that 'property is neutral'—the political counterpart of the economic notion that 'efficiency is neutral'. But while official statements avoid attaching a value to nationalisation *per se,* the enabling Acts clearly derive from such a notion: how else, for example, can the existence of monopoly power, regarded as socially damaging if deriving from private property, become a positive benefit if conferred by law upon a nationalised undertaking? Equally, if less obviously, how else can it be assumed that the managers of nationalised enterprises can be relied upon to concern themselves with 'the public interest' (and to know what it is), while private property owners can not?

Alongside the myth that 'property is neutral', there is a further one: the myth that the 'technical' management of nationalised industries can in principle be divorced from political control. Thus, the 'problem' of Ministerial, etc., interference with managerial decisions is seen as a matter essentially of finding the 'right' organisational structure, so that the relationship between the 'commercial' decision-process of the enterprise and the (political) policy-making process is in principle no different from that of private industry, though of course the channels of policy communication may be different. This myth ignores the fact that nationalisation of its very nature must imply that property in the relevant productive resources must inhere in Parliament and its institutions as agents of 'the community': there is no way in which ultimate political responsibility for the actions of the nationalised sector can be sequestrated.

IV. FROM MYTH TO REALITY

Central reasons for the persistence of the myths I have described are, first, the absence of well-articulated logical constructs capable of distinguishing the nationalised corporation and the private enterprise as organisational forms, and, second, a continuing failure adequately to distinguish these organisational differences from differences in objectives (a major example, already cited, being the refusal, in a policy context, to admit to preferences between the organisational forms *per se*).[3]

So far as the first of these is concerned, the most promising approach in my view is one which uses methodological individualism and some concept of group behaviour in the context of a theory of property rights. That is quite a mouthful: I shall try to explain it in everyday terms. The aim is to bring out differences in the relationships between the various participants in the economic decision-process in the two organisational forms. On the basis of particular assumptions about motivation, and about the detailed 'rules of the game' (property laws, nationalisation statutes, etc.), this should enable us to predict differences in the results of choosing one form of

[3] Some of the arguments here presented are developed in an interesting paper, as yet unpublished, by Robert Millward [5].

organisation rather than another. In an ideal world, we could then deal with the second problem, by appraising these differences against any 'value' we cared to attach to particular organisational forms. In this short paper, I can hope to do no more than sketch out the fundamentals of the approach: I hope it will be enough to persuade you of its potential, and to indicate some of the questions towards which further inquiry might be directed.

Methodological individualism

The essential proposition of methodological individualism is that an adequate model of socio-economic behaviour must treat *all* individuals as decision-makers pursuing their own interests (which does not, of course, preclude concern for the welfare of others).[4] This may seem obvious enough. But it needs to be specified for two reasons.

First, it is not the postulate underlying a good deal of 'orthodox' economic analysis. 'The worker' is there treated as a factor of production, responding automatically to the decisions of 'the entrepreneur'. Where trade unions are recognised, as in labour market theory, individuals still do not become decision-makers. As individuals, they are passive factors of production. As bargainers, they are completely identified with the objectives and behaviour of 'the union'. There is scant recognition, e.g., of a possible conflict between individual and group objectives. This is too simplistic for our present purposes.

Second, the values I treat as relevant to decisions, and to public policy, are the values perceived by individuals. Other papers will have dealt more fully with the relevant philosophical issues. My sole purpose is to emphasise that methodological individualism implies a rejection of any kind of organic theory of the state which superimposes higher 'values' on those of individuals. The notion embraces *conflicts* of individual values, but not 'superior' or 'external' values. The direct relevance of this is, of course, that there are strong historic ties between 'organic' philosophies such as Marxism and support for nationalisation. I do not propose to pursue this matter further. As I pointed out earlier, these philosophies lead to the rejection of private property *per se*, and are of little help in understanding the problems of the nationalised corporation in a mixed economy.

[4] A valuable survey of the literature using this approach is to be found in Littlechild [6].

Group behaviour

Traditionally, economic analysis has concentrated on the exchange relationship (direct transactions between individuals), to the relative neglect of non-market and group-participative behaviour. I think it is fair to say that we still lack a satisfactory *comprehensive* model of group behaviour, embracing firms, bureaucracies, pressure-groups, families, state corporations, governments and trade unions. I do not intend to try to elaborate such a model here. I want only to propose that the notion of methodological individualism can be used to develop such a model, simply by extending the scope of individual decision to embrace participation in group activities as well as the making of individual transactions.[5]

We can apply this concept to the theory of the firm operating in a private market environment. Professor Ronald Coase has explained the existence of firms as a set of processes withdrawn from the market [8]. We can elaborate this notion by recognising that there are various types of process, and various types of withdrawal, all depending upon the decisions of individuals and the environment in which they operate. Thus, in the case of a limited liability company there are the owners of the assets of the enterprise (who have chosen to hold rights in these assets rather than others), the management (whose members will have contractual rights and obligations with the company, chosen in preference to, for example, 'freelance' exchange transactions), and workers, also with continuing contractual relationships chosen in preference to 'casual' hiring.

Two things are noteworthy. First, the individuals concerned have chosen commitment to the firm in preference to a simple market (exchange) relationship. But it does not of course follow that their personal objectives must be identical with those of the firm: only that the individual predicts that this form of participation will best serve his own interests. Second, individuals may (and often will) simultaneously belong to more than one group. Workers, for example, will commonly be members of a trade union. There is nothing unnatural about this: that in particular circumstances the objectives of firm and union might be opposed obviously does not mean that an individual acting in his own interest cannot rationally be a member of both; nor does it mean that the worker may not

[5] A general model of this kind is developed in my paper 'Some Reflections on the Economics of Group Behaviour' [7].

participate in other groups concerned to increase (or decrease) trade union power.

It is apparent that the notions of methodological individualism and of group behaviour provide a method of comparison of different organisational situations. Before attempting this, however, we need to introduce our third concept, of property rights, since this is essential to an understanding of how decisions will in practice be made.

Property rights

The relevance of property rights to our problem is that the specification of those rights effectively determines the costs and benefits that individuals will expect to result from particular decisions, and so must influence the decisions themselves. An interesting example which has been of practical interest in the UK in recent years is the law relating to employment. The 'cost' to a worker of refusing to become a member of a trade union is determined by the consequences for his freedom to exercise his skill: the more the law supports the exclusion of non-members from employment, the higher union membership must be expected to be.

Interesting work on property rights, and on the application of the relevant concepts to our kind of problem, has been developing in the United States, and is associated particularly with the work of Alchian and Demsetz [9] [10]. Property rights in the relevant sense are the product both of law and of custom: the two together constitute the rights that individuals behave 'as though' they possess. (Alchian uses the term 'entitlement', both to escape the emotional overtones that have come to be associated with 'property', and to underline the relevance of custom and consent). The concept is clearly a sophisticated one. The law itself does not fully define property rights in an operational sense. For example, Ministers have legal powers over local authorities; but there are established consultative procedures ('entitlements') which they are expected to follow. The same is true of the exercise of Ministerial powers under the Nationalisation Acts. Equally, legal sanction is not necessary for entitlements to exist. Formally, private property in the legal sense exists only minimally in Communist countries. But no-one familiar with such countries would believe that those with political power do not enjoy significant entitlements.

Insofar as nationalisation changes entitlements, it will also change individual decisions and hence economic outcomes, save if the changes in entitlements are offset by changes in what individuals choose to maximise. I entitled this section 'From Myth to Reality': let us see if the ideas I have outlined can help us develop a realistic exposition of the character and problems of nationalisation.

V. THE PRIVATE FIRM AND THE NATIONALISED CORPORATION

This concluding section uses the argument of the preceding one to bring together, albeit very summarily, the essential differences in the situation of the individuals concerned in production and consumption in a firm in the private sector and in a nationalised corporation. Unavoidably in a short paper, what I offer must be something of a parody: but I think the essential points may emerge.

I earlier described the private firm, after Coase, as a set of processes withdrawn from the market, and identified three types of individual participants in its activities: 'owners' (the shareholders), 'management' (the directors), and 'workers'. In the private market environment, the firm can be seen as constrained on the one side by the capital market, and on the other by consumers and other (competing) firms. The capital market constraint results from the fact that owners are interested in the profitability of the firm, insofar as this is reflected in the capital value or yield of their property in it. The existence of a capital market ensures that they can reflect this interest either by action *within* the firm (e.g. by voting to change the management), or *outside* it (by selling their shares). The ease with which such changes can be made will be determined by the existing system of formal property rights (as reflected, e.g., in company law) and of less formal entitlements (such as the customary procedures for making management changes). The crucial point is that there exists a set of individuals with a direct interest in the profitable use of the firm's assets, and with institutional arrangements through which their emerging judgements can be reflected in new decisions.

Role of directorate in private firms

The directorate is responsible to the shareholders. As a group, the directorate must satisfy the shareholders. In doing so, it faces the constraints imposed by consumers, who can spend their incomes on other things, and of competitors, who have an incentive (from their own shareholders) to encourage consumers to do so. The nature of these constraints will vary *inter alia* with the state of competition in the industry concerned. But even in the most monopolistic sector, there is a continuing incentive for firms and individuals to try to break in by innovation: private markets are characterised by the search for new products/processes, success in which both confers short-term monopoly and stimulates competitive change by others.[6]

Individual members of the management group will, of course, pursue their own ends, which may not be identical with the ends of the owners. There is indeed a considerable economics literature devoted to managerial theories of the firm, built around the notion that firms may seek objectives other than profit, such as the maximisation of predicted sales or predicted growth. Much of this literature is unsatisfactory, however, in that it postulates these other objectives essentially as *alternatives* to the maximisation of profit, while the actual situation is one of *resolution* of conflicting objectives within the firm. Put crudely, the sales manager may correlate his predicted future income with the volume of his firm's sales. But other members of his management group will have different notions, and the group as a whole will have to adapt their individual objectives to satisfy the (profitability) interests of asset owners. This is not, of course, to say that no divergence of objectives between owners and management can exist, but that for firms in the private sector there are constraints upon the extent of such divergences, the particular efficacy of which will depend upon the detailed institutional arrangements (and related entitlements) concerned.

Finally, the workers. Workers commonly belong to a trade union 'group' as well as to the firm 'group'. I have already observed that in some circumstances the objectives of the two groups may be in conflict. But in the case of the firm in the private sector there is again a constraint. Insofar as workers claim higher incomes for themselves through participation in trade union action, they reduce the expected profitability of the firm, and hence, through the process already described, encourage the withdrawal or devaluation of the firm's capital and so jeopardise their own prospects of future employment or potential income from the firm.

[6] E.g., Kirzner [11].

Nationalised industry and private firm differences

In asking how the situation of a nationalised corporation differs, I shall again offer a 'thumbnail sketch' which largely ignores differences between individual nationalisation Acts in order to bring out the essentials. The differences can be summarised in seven propositions:

(1) There is no-one who has a *direct* interest in the fruitful use of the assets of a nationalised corporation, in the sense that he identifies his personal well-being with changes in that use. In Hayek's illuminating phrase: if everyone owns it, no-one owns it.

(2) The responsibilities of ownership are decided by the political process, and, effectively, inhere in the Minister identified in the enabling Act. But the Minister does not have available to him the set of direct sanctions available to the private market asset-holder. He cannot buy and sell the relevant assets, and he can divest himself of responsibility only by de-nationalisation—which is itself a piece of political rather than of economic behaviour.

(3) The difficulties of deciding the capital requirements of nationalised corporations derive directly from (1) and (2): *there can be no efficient market for the relevant assets.* (This difficulty is exacerbated by others discussed below: specifically, the effect of monopoly on asset values.)

(4) Management is not profit-responsible to the asset-owners in the fashion we identified for the private firm. On the one hand, this greatly widens the scope of managerial discretion, in that the checks on managerial efficiency are inevitably much more nebulous. On the other hand, the behaviour of Ministers (the *de facto* replacement of shareholders) is also less directly constrained (since there is no functioning capital market and no alternative asset owners), and consequently less predictable. Thus, the management of the nationalised corporation finds itself with considerable discretion, but nevertheless frustrated by arbitrary intervention in the decision-process.

(5) It is an implication of (4) that the scope for divergence between the objectives of the individual members of the management group, the group as a whole, and the responsible Minister, is much wider than in the private firm.

(6) Insofar as the nationalised corporations are legally protected from competition, it appears likely that, within the range of possi-

bilities at (5), managers will attach less significance to innovative activity than they would in the private market environment, since they have less to gain from it: there is an incentive to substitute bureaucratic for entrepreneurial behaviour.

(7) Finally, the constraints imposed upon the behaviour of workers and trade unions by the need to consider profitability is removed to the extent that Ministers can seek approval for the recovery of losses from the public purse. Unions and workers must be expected to behave differently in consequence, to the extent that they consider this kind of obligation to meet losses as an 'entitlement' conferred by nationalisation, and the predicted costs and benefits to themselves that they impute, e.g. to the disruption of production, are consequently changed.

None of these seven propositions is particularly novel. What is important is that we should recognise that *they are not the result of human fallibility or wickedness, but are inherent in the nationalised corporation as a form of economic organisation.* Recognition of this is the necessary starting-point for any programme of reform. Specifically, if de-nationalisation is thought to be 'politically impossible' (because the 'neutrality' myths are too powerful, and/or because of the very significant 'entitlements' that nationalisation itself generates, e.g. for present and imaginable future Ministers), then, apart from trying to dispel the myths, the questions to be asked should concern the possibility of improving the set of decision-relationships that I have specified.

My own preferred starting points for such an inquiry would be the possibilities of exposure to competition, on the one hand, and the clearer elaboration of decision responsibilities (including an obligation on Ministers to make public not only their instructions but their prediction of the consequences), on the other. I have little faith in the creation of more committees: toothless watchdogs have little difficulty in eating, but cannot bite.

But reform is a subject of itself: I do not here pretend to have done more than offer a way of thinking about it.

POSTSCRIPT

on Cmnd. 7131: The Nationalised Industries

The White Paper was published in March 1978, and I did not see it in time to comment upon it in the main text. I hope to deal with it more fully elsewhere, and confine myself here to observations on its consonance with the thesis of this paper.

At first blush, the myths I have discussed might appear from the White Paper less pervasive. The practical irrelevance of the long-run marginal cost 'rule' has been recognised, and it is no longer to be used. That nationalisation necessitates Ministerial involvement in the decision-process is also recognised, and it is proposed that the predicted consequences of the changes made to nationalised industry plans on Ministerial instructions should be quantified.

A more careful reading, however, suggests that changes are not being made because the myths have been dispelled and the true nature of the problems recognised, but rather that experience has brought dissatisfaction with some practices, so, pragmatically, we must try something different. There are important respects in which the true nature of the problem to be solved still goes unrecognised.

First, despite the abandonment of the marginal cost pricing 'rule', and some obscurity in the argument, the proposed pricing and investment rules are clearly related to private-sector concepts of economic efficiency. But a new confusion has entered, for it is also asserted that nationalised industries cannot become bankrupt, and no possible incompatibility between the two positions is recognised.

Second, the proposed changes in the behaviour of the Minister do nothing to deal with the loss of the function of private asset-holder, and since the Minister's 'social responsibilities' are also re-asserted, it would be unwise to predict that the exercise of their scope for discretion by Minister and managements, and the consequent confusion and uncertainty, is going to be much inhibited by the new arrangements.

Third, there is a piquant reference to the need, in the appraisal of individual investment projects, to allow for 'appraisal optimism'. But there is no discussion of why such optimism is believed to exist. Could it just possibly be because, following the lines of my argument, the managers making investment decisions find their opportunity-cost situation very different from the profit-responsible situation in private industry? The recent history of the British Steel Corporation suggests that the possibility is not entirely remote.

If so, can we really make much progress by subjecting the optimistic judgements of one unconstrained group (the managers) to the scrutiny of others (such as the Treasury) for whom profit responsibility is of even more remote personal concern?

REFERENCES

[1] Chester, Sir Norman, *The Nationalisation of British Industry, 1945-51,* HMSO, 1975.

[2] Wiseman, J., 'The Theory of Public Utility Price—An Empty Box', *Oxford Economic Papers*, February 1975.

[3] Wiseman, J., 'Growing without Nationalisation', in *Growth Through Industry,* IEA Readings No. 2, 1967.

[4] Foster, C. D., *Politics, Finance and the Role of Economics,* Allen and Unwin, 1971.

[5] Millward, Robert, 'Public Ownership, The Theory of Property Rights and the Public Corporation in the UK' (mimeo).

[6] Littlechild, S. C., *Change Rules, OK?*, Inaugural Lecture, University of Birmingham, 1978.

[7] Wiseman, J., 'Some Reflections on the Economics of Group Behaviour', *Festschrift* for Professor Biucchi (forthcoming).

[8] Coase, R. H., 'The Nature of the Firm', *Economica,* n.s. IV (1937).

[9] Alchian, A. A., *Some Economics of Property,* RAND Corporation Paper P-2316, 1961.

[10] Demsetz, H., 'Towards a Theory of Property Rights', *American Economic Review,* Papers and Proceedings, May 1967.

[11] Kirzner, I. M., *Competition and Entrepreneurship*, Chicago: University of Chicago Press, 1973.

Discussion

DOUGLAS EDEN (*Middlesex Polytechnic*): Any organisation that affiliates to the TUC is far from being non-political and non-partisan; the TUC has the nationalisation of the means of production, distribution and exchange written into its constitution. The relationship of the TUC to the Labour Party raises the question, for Professor Breton, whether political careers are primarily dependent on the electorate in the first place. This is also relevant to Professor Wiseman's paper, where he says that workers as trade unionists, in making demands of private firms, endanger the firm and therefore their own long-term interest because their demands can lead to bankruptcy. I suggest this has led, and will in the future lead, not to bankruptcy but to demands for further nationalisation, and successfully so.

Both Professor Wiseman and Professor Breton seem to address themselves in terms of bribery and bargaining in talking about demands or preferences in representative democracy and demands for nationalisation. I would like to hear them say something more about the developing uses of intimidation in coercion within an increasingly imperfect representative democracy.

PROF. WISEMAN: First, when I talked about the myths, I was in no doubt that there are people, organisations and so on, committed to nationalisation of the means of production, distribution and exchange. The point is that in all government statements on public policy, it is never openly acknowledged that there is a preference between the forms of economic organisation. In all the documents purporting to govern the behaviour of these organisations, neutrality is not only implied, but in some cases is made explicit. Thus, of the two White Papers, the earlier one explicitly adopts a notion of economic efficiency that assumes that the form of organisation is neutral. The new White Paper is not quite so bad, but it is perhaps more confused; in one place it does put forward such a notion of neutrality, yet elsewhere says that it is impossible for a nationalised enterprise to become bankrupt. To me, confusion is no defence. It merely means the myth continues, and that the people concerned understand the problem even less than they did before.

Second, the demand for nationalisation by unions in the private sector seems based entirely upon the notion that their earnings would be strengthened by it. They have observed what it does for other unions and they want it for themselves. This strengthens the notion that, in the private sector, constraints exist which can be got rid of by the act of nationalisation.

PROF. PEACOCK: It is very interesting to see Jack Wiseman turning into a professor of sociology. Has he reached a stage in his investigations where he can specify a utility function for nationalised industry managers? There is a certain amount of this theory floating around, drawing an analogy between the nationalised industry manager and the bureaucrat in the ordinary government department. One proposition, which I wondered if he supports, is that the manager will try at all cost to so have the accounts arranged that they show neither profits nor losses, because if you show a profit unions get restive and their wage claims are increased, and if you make losses parliamentary committees and Ministers are breathing down your neck. There are similar rather naïve propositions in the theory of bureaucracy.

PROF. WISEMAN: I am less interested in this than in the identification of the range of discretion available for the behaviour of such people. The significant point is less how managers behave but rather that we have to depend both on their goodwill and their understanding of what we want of them, without being able to impose constraints that direct their behaviour to what we, as the community, might want. This seems to me the significant element.

As to behaviour, the proposition has been made, by people observing this strange community of ours from outside, that the nationalised industry managers were maximising the probability of honours and awards, since the people appointed already had all the money they wanted, and that they negotiated hefty pension rights in substitution for the incomes they could not be paid. Their behaviour, therefore, would be concerned with some attempt to conform with what they thought their Minister wanted, should they ever discover it to be possible to find out what it was.

PROF. PEACOCK: In view of that reply, what is Professor Wiseman's view of the case study method?

PROF. WISEMAN: It's all we've got.

LORD ROBBINS: Does the case study method really bear out this last hypothesis? To me it is an unanswered question why the heads of nationalised industries have accepted these jobs. They could certainly make more money elsewhere. Most of them have already received such honours as would give anybody half-an-hour's private satisfaction. They have a hell of a time with Ministers, and it is very difficult to understand their motivation. Perhaps we haven't had enough cases yet.

PROF. WISEMAN: And the length of life is so short.

RACHAEL TINGLE: Professor Wiseman seemed to be saying, much to my surprise, that he did not think there were any public goods provided by the British Government. Perhaps I am old-fashioned but I am in favour of the nationalisation of the atom-bomb-dropping industry. I think that where government goes wrong is that it fails to supply those goods which are indeed public goods, whereas it over-supplies goods which are *not* public goods, such as education and recreational facilities.

PROF. WISEMAN: What I said was that I can't think of any goods delivered by nationalised industries that have any significant aspect of publicness that distinguishes them from other goods. I did not say that the Government does not deliver any public goods—I have not thought much about that. Indeed I do not believe there are many public goods: I believe there are poor systems of property rights.

PROF. ROWLEY: The approach Professor Wiseman used in analysing the behaviour of organisations in different institutional contexts was also used by George Yarrow and me at Newcastle. We have carried out an analysis of one industry using very much this sort of approach, modelling it in terms of the utility functions of all the relevant actors.

The British steel industry is a very helpful one for a case study because, of course, we have a period from 1953 through to 1967 where it was operating under private enterprise conditions, albeit a regulated cartel, and then a break-point in 1967. We did, in the light of certain predictions, emerge with a theory or analysis of the different institutional frameworks. Certain predictions we could not make at all, because it is difficult to compare a regulated cartel with a nationalised industry. But we did obtain predictions on productivity, technical progress, rate of diffusion and so on. We then compared the behaviour of the industry in the pre-nationalisation period, predicted what should have been the outcome in the post-nationalisation period had it continued as it was then operating, and compared it against our theory of what we expected to happen. And it was very significant that nearly all the predictions indicated by the theory were supported by the evidence on the industry. So the case study approach can be used. But typically the difficulty is that you do not get a break in the institutional framework. If you have nationalisation over a long period, you have nothing really to compare it with except other countries, and that is very inconclusive.

PROF. STEPHEN LITTLECHILD (*University of Birmingham*): May I draw out one implication of Professor Wiseman's paper and the public choice literature generally? The 1967 White Paper on Nationalised Industries broadly reflected the prevailing opinion amongst economists that the nationalised industries were passive vehicles of government policy, and the appropriate task therefore was to lay down rules of behaviour for these industries which would lead them to do the right things.

Professors Wiseman and Buchanan and others have emphasised that nationalised industries are not passive vehicles; that they are organisations with motives of their own. This, I think, calls for some revision of the rules of behaviour laid down for them. Nonetheless the question is then posed: if they are not supposed to set price equal to long-run marginal cost, for example, what are they supposed to set price equal to?

The work we have been talking about this morning brings two answers to that question. One is that it does not really matter what you *tell* nationalised industry managers to do, because they simply won't take any notice. And the second answer is that it is much more important to ask a different question, namely, how *do* they behave? How do industries which are nationalised behave in ways different from when they are not nationalised? And how do different kinds of frameworks affect their behaviour? So one is led into the positive economics of what does happen and why, rather than the normative economics of what should happen. When we ask: 'What *is* the behaviour of such industries?' we are led on to a different kind of normative question: What kinds of behaviour do we wish to encourage on the part of such industries?

PROF. BRETON: I have a short comment on case studies. If one focuses on nationalised industries in the UK or elsewhere in trying the case analysis, one tends to forget that, on the demand for nationalisation, there are a lot of substitutes: such as the imposition of tariffs, the extension of loans, subsidies and grants, which do lead to rapport between governmental Ministers and the nationalised managers. This makes comparison with so-called private-sector industries much more difficult than appears at first sight, because if the one selected is protected by tariff or loans, or by subsidies, etc., it is not comparing with unsubsidised or unprotected industry.

I think it is not possible to do case studies of nationalised industries to find out why they exist and what is the demand for them: whether it originates with the nature of the coalition that wants them (a coalition not of consumers but of some members of the citizenry). We are not simply talking about the consumers of the product of these industries. To find out all these characteristics, it is absolutely essential to study not exclusively nationalised industries but the full spectrum of the ways governments try to change the distribution of income, to favour some groups, and elicit support. If we think they are trying to do something else, case studies would tell us. But they are very dangerous instruments which can blind us to the full spectrum of the ways governments operate in the real world. Simply focusing on nationalisation can blind us more than it helps us to understand what is going on.

JOHN BURTON (*Kingston Polytechnic*): Professor Wiseman has offered us a sort of primordial hypothesis of nationalisation, that it is one way of widening the entitlements of various producer groups, and that is possibly why they demand it. I wonder whether he would care to elaborate and tell us why we get variations in the demand for nationalisation by producer groups, across industry and across countries. Why is the demand for nationalisation by producer groups lower in the United States, for example, than it is in the UK? Is it because American trade unions, for instance, seem to have a lower regard for nationalisation than their British colleagues?

PROF. WISEMAN: If I started trying to answer your question, I would become partly the sociologist Professor Peacock says I am, and partly an economic historian. I don't mind that: we need some good sociologists. I think the answer requires a broader approach than anything available to me now. I think there are probably good historical reasons, associated, among other things, with the organisation of trade unions and the way their powers have developed.

On the potential of case studies: There are observations of a case study kind to be derived from the changing perception of nationalised industry by the relevant public sector decision group, that is, Ministers, responsible civil servants and so on. I am hoping to do a rather more detailed comparison of the content of the earlier White Paper and the new one. There are indicators in various places that learning about the nature of the problems I have been discussing has being going on in the public sector. One example is that, although the long-run marginal cost principle has been abandoned, it is because some economists tell Ministers there are better ways to price, and that government control can be based on the required rate of return. But this required rate of return is to take account of relative riskiness. Now that is an interesting example of the change in the decision process caused by nationalisation: the people who are going to appraise relative riskiness now appear to be the Treasury in collaboration with the nationalised industry managers. Two observations are immediately relevant. First, they say they are going to appraise risk by taking account of, I think the phrase is, 'the propensity to excessive optimism', which seems to me a marvellous way of saying: 'If I don't suffer, I'm optimistic'. Second, there is no reference anywhere to the checks and penalties attached to being *wrong*, since none of the people who are appraising riskiness are themselves taking any risks.

There are several further examples of precisely the same kind, to show that the policy-makers or their advisers are becoming increasingly aware of the implications of nationalisation for the decision process, but appear to remain unaware of the mythology that lies behind the problems concerned.

Afternoon Session Chairman: ***Max Hartwell***

4. The Political Business Cycle: Theory and Evidence

BRUNO S. FREY*
Universities of Zürich and Basel

* The author would like to thank Sandra Stuber for rendering the text into English prose.

The Authors

The Chairman:

MAX HARTWELL: Joint Director, Centre for Socio-Legal Studies, Wolfson College, Oxford, and Faculty Fellow, Nuffield College, Oxford. Formerly Reader in Recent Social and Economic History, University of Oxford, 1956-77.

Editor of *The Economic History Review,* 1957-72. Author of *The Industrial Revolution,* 1970; *The Industrial Revolution and Economic Growth,* 1971; (with R. W. Breach) *British Economy and Society, 1870-1970,* 1972. For the IEA he contributed an essay 'The Consequences of the Industrial Revolution in England for the Poor', in *The Long Debate on Poverty,* Readings 9, 1972 (Second Edition, 1974).

BRUNO S. FREY: Professor of Economics, Institute for Empirical Economic Research, University of Zürich. Born in Basel, Switzerland, 1941; studied at the University of Basel (Lic. Rer. Pol., 1964, Dr Rer. Pol., 1965). Official Visitor, Christ's College, Cambridge, and Visiting Lecturer, Wharton School of the University of Pennsylvania; 'Habilitation' in Basel, 1969, then University Lecturer and Associate Professor; Ordinary Professor, University of Konstanz, W. Germany, 1970-77; Guest Professor, later Dean of the Faculty of Social Sciences, University of Linz, Austria, 1973-76; research at the Cowles Foundation, Yale University, Princeton University and Nuffield College, Oxford, 1975-76; since 1977, chair in economics at the University of Zürich.

Managing Editor of *Kyklos* (the international journal of the social sciences). Author of *Towards a Mathematical Model of Government Behaviour,* 1968; *Product and Process Innovations in Economic Growth,* 1969; *Umweltökonomie (Environmental Economics),* 1972; *Modern Political Economy,* 1978.

BRUNO S. FREY:

I. CASUAL OBSERVATIONS

The fact that governments actively create business cycles in order to improve their re-election chances, and do not simply follow the Keynesian prescription of anti-cyclical policy, has often been observed in the United Kingdom. Thus, in 1969, Professor Robin Matthews [1] pointed to a 'government-driven cycle' and Angus Maddison [2] even suggested that 'government action is the proximate cause of most upswings and downswings'. Earlier, in 1964, Mr. J. C. R. Dow [3] noted in his analysis of the British economy between 1945 and 1960 that 'fiscal and monetary policy failed to be stabilising'. Similar arguments have been advanced by Professor Alan Prest [4] and Mr Samuel Brittan [5] for later periods. Another type of Marxian-inspired political business cycle following from the government's use of Keynesian macro-economic steering was very early suggested by Kalecki in 1943 [6].

Over the last few years, the economic theory of politics has devoted considerable attention to the idea of politically induced cycles. Its theoretical bases have been analysed and its existence has been the subject of empirical studies.

II. THEORETICAL APPROACHES

The Phillips Curve describing the trade-off between inflation and unemployment has provided a convenient starting point for the theoretical analysis of political cycles. The rate of inflation is taken to be dependent on the rate of unemployment as well as on inflation expectations prevailing in the population. The larger the unemployment, and the lower the expected inflation, the lower, it was thought, the actual inflation would be. Inflation expectations are taken as being dependent on recent experience of inflation. If this relationship holds in the economy—and there was considerable empirical evidence that it does—a government able to control the rate of unemployment by fiscal and/or monetary policy can increase its chances of re-election by producing a political business cycle. The voters dislike both unemployment and inflation, and will tend to support a government which provides high employment and stable prices at election time.

A government intending to maximise the number of votes received at election time should thus pursue the following policy: immediately after being elected (or re-elected), it should undertake a deflationary policy by increasing the rate of unemployment to combat inflation. Over the course of the period of government, unemployment should be reduced continuously to reach its minimum at election. The creation of this cycle is fruitful for election purposes because the deflationary policy undertaken at the beginning of the term of office constitutes an investment in the future: inflation expectations are depressed and the whole Phillips Curve shifts towards the origin, making it possible to have both inflation *and* unemployment lower at election time. Accelerated inflation *after* the election date due to low unemployment does not concern a vote-maximising government, whose time-horizon is confined to the current election period.

The optimal political business cycle from the government's point of view then has the following shape (Fig. 1):

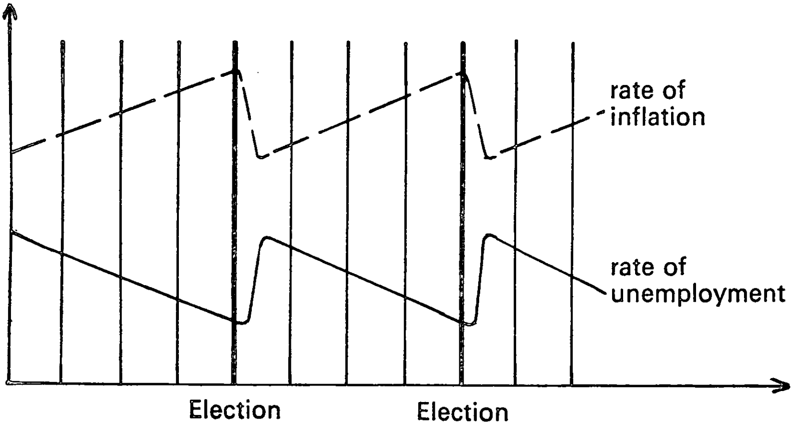

Fig. 1
Vote-maximising election cycle

The rate of inflation rises over the election period; reaches its maximum shortly after the election; is then quickly reduced by a deflationary policy to rise again thereafter. The rate of unemployment continuously falls over the period of office and increases strongly after an election.

Another political business cycle is even easier to imagine, as it relies on the voters' interest in rapid income gains and simply takes advantage of the time-lags inherent in the economic system. Increases in the rate of inflation as a rule occur after an upswing in production, and after a reduction in the rate of unemployment. A government interested in winning votes at election time is little concerned with the price increases that will occur after the election. It will undertake a strongly expansionary policy as the election approaches, and the voters will benefit from high income increases (and low unemployment) at election time. If the election is nevertheless lost, the high inflation thus induced will still make itself felt under the next government—which is formed by the opposition—and this increases the chances of the government returning to power soon.

III. EMPIRICAL OBSERVATIONS

Have governments produced such election cycles with decreasing unemployment, rising inflation and rising growth of income?

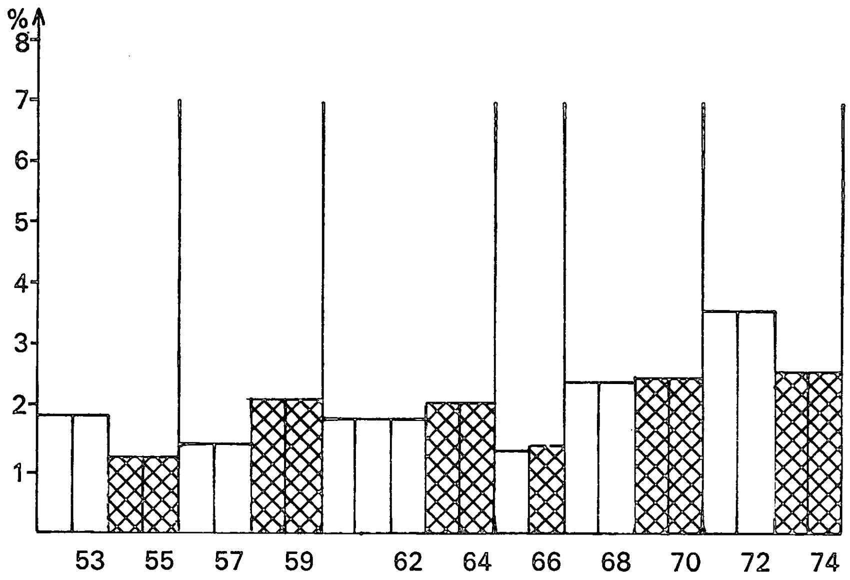

Fig. 2
Rate of unemployment (per cent) over the six election periods 1952-74,
United Kingdom

Fig. 2 shows the development of the rate of unemployment (as a percentage of the labour force) over the six government periods 1952 to 1974 in the United Kingdom. (For simplicity's sake, the periods are taken to cover complete years.) The government periods are divided into two post-election years (white) and two pre-election years (criss-crossed); in 1965-66, these periods comprise only one year each. The rate of unemployment was lower in the second as compared with the first half of the election period in 1952-55 and 1971-74. In the election periods 1956-59 and 1960-64, the rate of

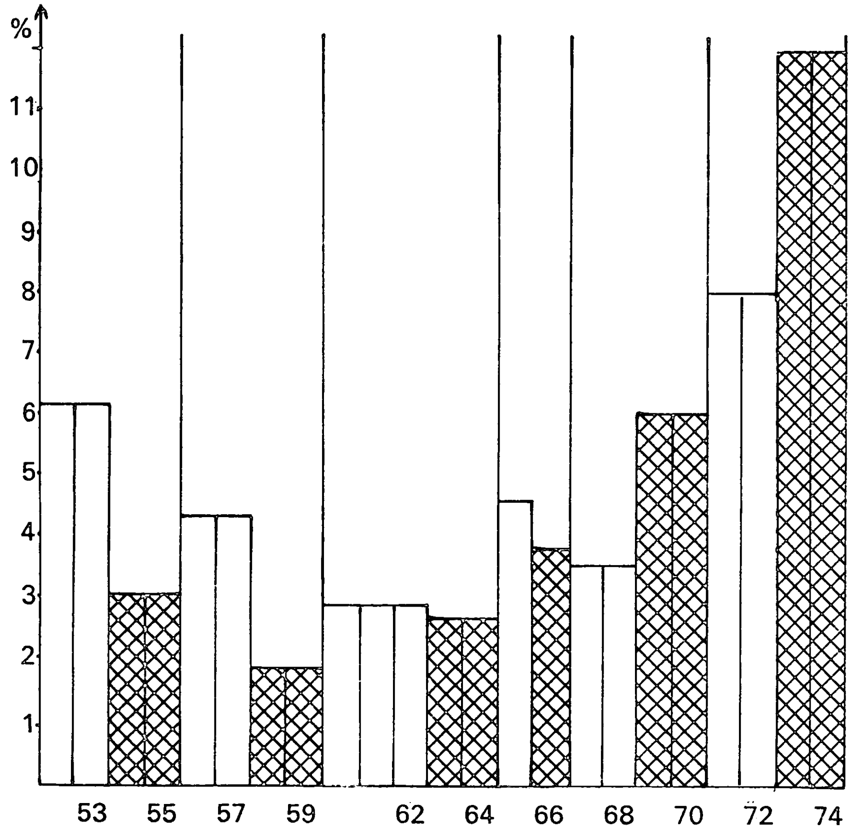

Fig. 3
Rate of inflation (per cent) over the six election periods 1952-74, United Kingdom

unemployment was clearly higher in the second as compared with the first part of the term.

Fig. 3 shows the development of the rate of inflation. It corresponds to the vote-maximising business cycle discussed above only in the government periods 1967-70 and 1971-74, when inflation was higher in the second part of the election period than the first part. During the other government periods the inflation rate was lower in the years before than in those after an election. It should be noted

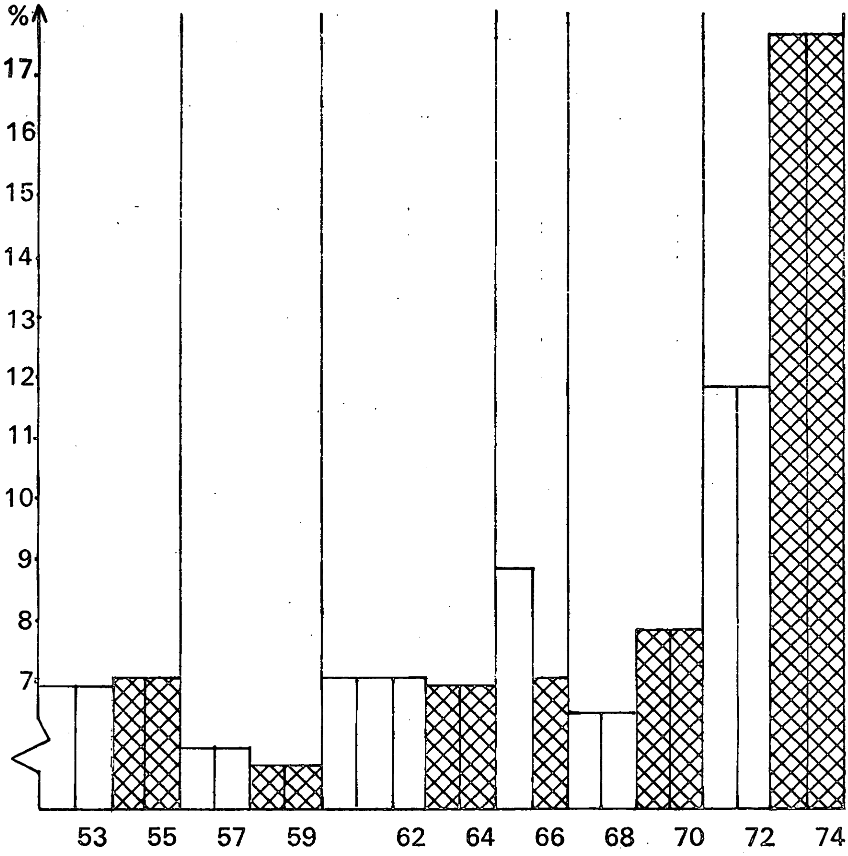

Fig. 4

Growth rate of disposable nominal income (per cent), over the six election periods 1952-74, United Kingdom

that there has been a strong trend towards increases in inflation since the mid-1960s.

The development of these two macro-economic variables (the rates of unemployment and of inflation) gives little evidence for the particular vote-maximising election cycle based on the Phillips Curve referred to above. This conclusion applies not only to the United Kingdom but also to the United States and Germany [7].

For the United Kingdom, there is no political business cycle observable in the macro-data on income growth. As is shown in Fig. 4, the percentage rate of increases in disposable nominal income was clearly higher before (as compared with after) elections only in the last two government periods, 1967-70 and 1971-74. In the election of 1966 the growth rate was much lower than in 1965,

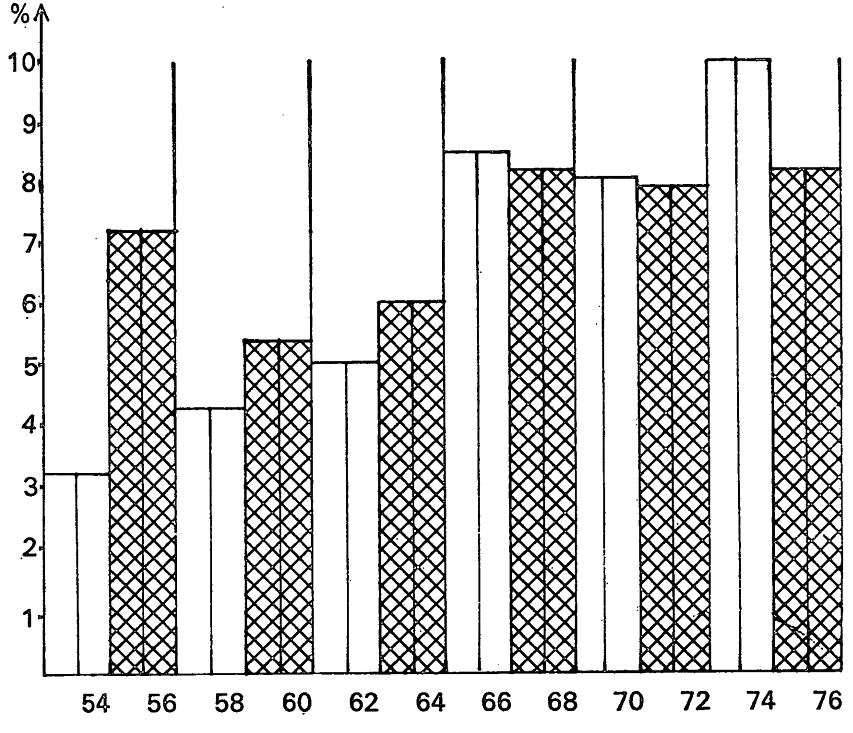

Fig. 5

Growth rate of disposable nominal income (per cent), over the six presidential administrations 1953-76, United States

but it should be noted that the election took place early, on 31 March. In all the other election periods there is no clear difference between pre- and post-election years.

In the United States, a political business cycle in terms of growth of disposable nominal income is clearly visible for the first three election periods considered, namely Eisenhower's two terms (1953-56, 1957-60) and the Kennedy/Johnson term (1961-64). The growth rate of income was, however, clearly lower in the two pre-election years of the joint Nixon/Ford administration (1973-76) compared with the post-election years (Fig. 5).

In Germany, there is weak evidence for the existence of an electoral cycle in terms of the growth rate of nominal income. In five election periods (1950-53, 1954-57, 1958-61, 1966-69, and 1973-76) there is an increase in the growth rate in the second half of an election term as hypothesised, but the opposite is true for the periods 1962-65 and 1970-72 (Fig. 6).

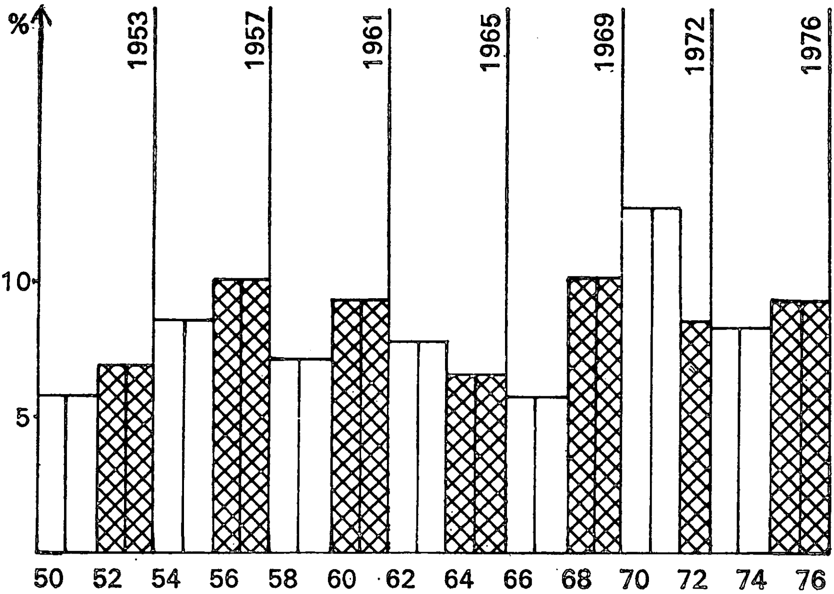

Fig. 6
Growth rate of disposable nominal income (per cent), over the seven election periods 1950-76, Germany

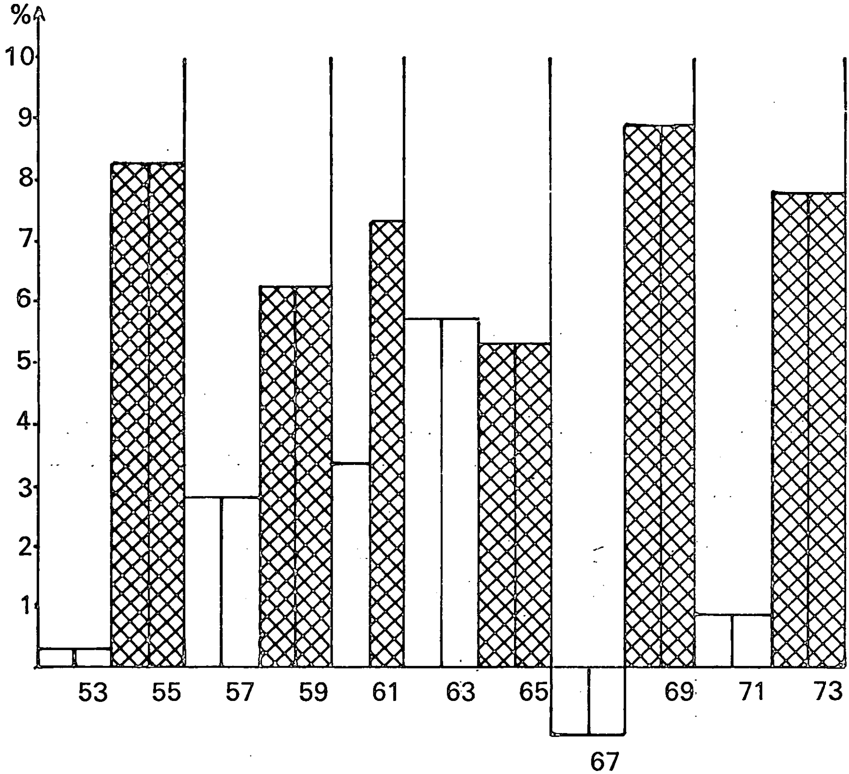

Fig. 7
Growth rate in per capita consumption (per cent), over the six election periods 1952-73, Israel

The clearest evidence by far for a politically produced business cycle as evidenced by aggregate economic variables is shown by Israel. With the exception of one election term (1962-65), the growth rate of per capita consumption was always much higher in the two years preceding an election for the Knesset than in the years thereafter (Fig.7).

The empirical results presented are quite sensitive with respect to the exact definition of the economic variables, the periods considered, and the breakdown between pre- and post-election years. If, for example, the growth rate of real (and not nominal) income in the

TABLE 1

THE GROWTH RATE OF DISPOSABLE REAL INCOME IN THE PRESIDENTIAL ELECTION YEAR COMPARED TO OTHER YEARS, 1933-1973, UNITED STATES

	Year with presidential election	*Years without presidential election*
Increasing growth rate	10	24
Decreasing growth rate	0	7

United States in presidential election years is compared with its value in the three non-election years over a 40-year period, an election cycle becomes more apparent [8]. Table 1 shows that the growth rate of real income increased in all the presidential election years. In the years with no presidential elections, income growth increased in 24 years only, and decreased in seven.

Empirical evidence unclear

The Figures and Tables presented as empirical evidence create a mixed impression. Though some political business cycles can be detected (mostly for growth in income and consumption), it is on the whole not possible to identify a clear and regular political business cycle. Various reasons may account for this, such as the international inter-dependence among industrial countries and the fact that there are other important elections in between general national elections (e.g. congressional elections in the US, state elections in Germany).

The approach of examining raw data only over time is seriously deficient. A careful empirical study requires an *isolation* of the election cycle: all influences not connected with it must be excluded. Even if a political business cycle may be detected, the fluctuations observed *may* be due to other things such as the traditional four- or five-year economic business cycle. If, on the other hand, no election cycle is visible in the macro-variables considered, it cannot be concluded that no such cycle exists: it may be swamped by other phenomena. The only way to isolate electoral cycles from other influences is to construct carefully formulated theoretical models which specify exactly in what way the government is envisaged to create political cycles. Only if the hypotheses advanced on this basis are not rejected by econometric—or rather 'polito-metric'—testing is it correct to suggest that political business cycles do in fact exist.

IV. POLITO-METRICS

The possible existence of political business cycles may be tested within the framework of politico-economic models which analyse the inter-dependence between the economy and polity.[1] A very simple model which has the advantage of having been empirically tested will now be sketched.

The interaction between the economy and the polity is captured by two functions:

(*a*) The *popularity function* shows the influence of economic conditions on current government popularity, as regularly measured by Gallup or other national opinion polls. The popularity index serves the government as an indicator of likely future election outcomes. The rates of unemployment, inflation, and growth of income are the most important economic determinants of government popularity and election outcome.

(*b*) The *policy function* describes the government's reaction to its projected chances of re-election. If, owing to a low popularity index, re-election is seen as being in danger, the government uses policy instruments at its disposal to improve economic conditions. If, on the other hand, public opinion polls point to a comfortable re-election, the government can afford to take economic actions that correspond to its ideological position even if they do not necessarily bring in votes. Government is thus not assumed to be continually maximising votes but rather to maximise its own utility, i.e. to undertake ideologically motivated policies, subject to various constraints. The most important constraint is the necessity of being re-elected (because otherwise the ideological programmes cannot be realised); besides these are economic (budget and balance-of-payments) and administrative constraints.

The popularity and policy functions sketched have been empirically

---

[1] A survey of the various approaches and models constructed is in Bruno S. Frey, 'Politico-Economic Cycles and Models', *Journal of Public Economics*, 9, 1978, pp. 203-20.

TABLE 2
THE INFLUENCE OF ECONOMIC VARIABLES ON GOVERNMENT POPULARITY IN THREE COUNTRIES, POST-WAR PERIOD

	Country and period		
Economic variables (percentage points)	*U.K. (1959-74)*	*U.S.A. (1953-75)*	*Germany (F.R.) (1951-75)*
Rate of unemployment	−6·0	−4·2	−0·9
Rate of inflation	−0·6	−1·0	−0·7
Growth rate of real disposable income	+0·8	+0·4	+0·4

estimated for various countries.[2] Table 2 shows the influence of the three macro-economic variables mentioned above on government popularity in three countries, based on quarterly polito-metric estimates.

In the United Kingdom in the period 1959 to 1974 an increase in the rate of unemployment of one percentage point decreased government popularity by 6·0 percentage points; the same increase in the rate of inflation reduced it by 0·6 percentage points. A rise in the growth rate of real disposable income raised government popularity by 0·8 percentage points. The impact of economic variables on popularity was of similar magnitude in the United States, while unemployment in Germany seems to have had a much smaller impact on government popularity than in either the UK or the US. It should be noted that the figures presented serve only as a rough indication of the magnitudes involved, and apply only to the periods indicated. The estimates depend, of course, on the exact specification of the popularity function.

For reasons of space it is not possible to present here the complete numerical estimates of the policy function. It must suffice to state the results verbally. The polito-metric estimation results suggest for all

[2] A complete presentation of the particular estimates is provided in Bruno S. Frey and Friedrich Schneider, 'A Politico-Economic Model of the United Kingdom', *Economic Journal,* 88, June 1978, pp. 243-53; 'An Empirical Study of Politico-Economic Interaction in the U.S.', *Review of Economics and Statistics,* 60, May 1978, pp. 147-83; 'An Economic Model with an Endogenous Government Sector', *Public Choice,* 1978 (forthcoming).

three countries considered that governments are well aware of the effect of economic policy measures on their popularity, and that they do indeed use economic policy instruments in order to secure re-election. The multiple regression technique used allows us to separate this politically motivated activity from other influences such as the need to balance the budget or to keep within the limits set by the balance of payments. This approach also allows us to isolate those periods in which the party in government is actively concerned with re-election. The estimated results for all countries (for the same time periods as in Table 2) suggest that, *ceteris paribus,* governments pursue an expansionary policy before elections when they are afraid that they will not be re-elected. The expansion undertaken will be all the larger the more re-election seems to be threatened and the closer the election day approaches. Governments actively produce in this case a politically motivated business cycle.

V. EVALUATION

Politico-economic models and their polito-metric estimation provide a basis for believing that governments have an interest in creating political business cycles. Traditional business cycle literature and textbooks have completely disregarded this aspect and the theory of stabilisation policy has assumed as a matter of course that the government should, and actually does, stabilise the economy. The economic theory of politics thus provides a quite distinct and new view of business cycles.

What can be done to prevent or at least reduce political business cycles? Clearly, there is little use in advising the government not to create such cycles because government is an *endogenous* part of the politico-economic system. It is not willing and/or not capable of following such advice if the creation of business cycles is to its advantage. There seem to be only two solutions possible:

(i) At the level of the 'constitution', a contract [9] can be entered into which makes it impossible or unattractive for governments to produce political business cycles. One such arrangement would be to lengthen the electoral period, in which case political cycles would disappear altogether or at least be dampened. Another possibility would be to take economic policy out of the hands of politicians and give it to 'non-partisan' institutions such as the central bank or the planning board. Such an idea is behind the monetarists' proposition that the central bank's activity should be restricted to increasing the stock of money by a constant amount each year. It remains doubtful whether this institutional arrangement would solve the problem; it is rather likely that new forms of business cycles (or other inefficiencies) would be produced, although now for administrative or bureaucratic purposes. It is clear that both lengthening the electoral period and establishing institutions outside democratic control (in the post-constitutional state) have the major disadvantage that the economic policies undertaken may be remote from voters' preferences. The political economist's task is to suggest other, possibly innovative, solutions for constitutional contracts both guaranteeing voter sovereignty and preventing politically induced economic fluctuations. An example would be Professor F. A. Hayek's proposal for the private and competitive supply of money (whose advantages and disadvantages would, of course, have to be carefully considered) [10].

(ii) Voters may be educated by a process of 'social learning'. They can start realising that the government produces cycles in order to improve its re-election chances. Once this is understood, the electorate will punish governments behaving in this way, which will in turn make it unattractive for politicians to follow this route. It may be shown that when voters fully recognise the functioning of the particular politico-economic system they live in—i.e. when voters' expectations are 'rational'—the political business cycle (of the type referred to in Section II of this paper) breaks down.

BIBLIOGRAPHY

[1] Matthews, R. C. O., 'Postwar Business Cycles in the UK' in M. Bronfenbrenner (ed.), *Is the Business Cycle Obsolete?,* Wiley, New York, 1967, p. 107.

[2] Maddison, A., 'Comment', in *ibid.,* p. 500.

[3] Dow, J. C. R., *The Management of the British Economy, 1945-60,* Cambridge University Press, 1964, p. 384.

[4] Prest, A. R., 'Sense and Nonsense of Budgetary Policy', *Economic Journal,* 78, 1968, p. 5.

[5] Brittan, S., *Steering the Economy,* Secker & Warburg, London, 1969, p. 267.

[6] Kalecki, M., 'Political Aspects of Full Employment', *Political Quarterly,* October/December, 1943.

[7] Frey, Bruno S., *Modern Political Economy,* Martin Robertson, London, 1978.

[8] Tufte, Edward R., 'The Political Manipulation of the Economy: Influence of the Electoral Cycle on Macroeconomic Performance and Policy', *American Political Science Review* (forthcoming).

[9] Buchanan, J. M., 'A Contractarian Paradigm for Applying Economic Theory', *American Economic Review, Papers and Proceedings,* May 1975, pp. 225-30.

[10] Hayek, F. A., *Denationalisation of Money—The Argument Refined,* Hobart Paper 70, IEA, 2nd Edition, 1978.

Discussion

PROF. S. ANDRESKI (*University of Reading*): I would think *a priori* that taxation would show the political business cycle better than anything else. Is there any evidence for this hypothesis?

PROF. FREY: We have tried to introduce taxes into a popularity function but we haven't found any evidence that it has a statistically significant influence. Most other authors came to the same conclusion. The possibility, however, that the negative evidence is due to an econometric problem cannot be excluded.

PAUL WHITELEY (*Kingston Polytechnic*): I would like to ask you about the estimates you put up on the board, particularly in relation to the United Kingdom. Professor Frey, you will know the work by Goodhart and Bhansali,[1] which you criticised in an article.[2] They found not entirely the same but similar results, showing that unemployment affected government popularity as did inflation. But there were econometric problems with their estimates. I have been experimenting with similar work and find that, particularly if you try to correct for auto-correlation, the

[1] C. Goodhart and R. Bhansali, 'Political Economy', *Political Studies,* XVIII, 1970, pp. 43-106.

[2] B. S. Frey and H. Garbers, 'Politico-Econometrics—on estimation in political economy', *Political Studies,* XIX, 1971, pp. 316-20.

estimates seem to disappear. Would Professor Frey say something about the way he estimated these relationships, because it is very crucial to the outcomes?

PROF. FREY: We have found that it is very important to specify the equation correctly. First, you have to take into account that each government leader (in the case of the United Kingdom, each Prime Minister) has a popularity level of his own, which has to be accounted for by a suitable dummy variable. Secondly, you have to take into account 'depreciation': a government's popularity typically falls over time. That is a well-known phenomenon in the UK. There is also an autonomous upswing of government popularity as an election approaches. You have to model this again by introducing appropriate dummy variables. If this is done, the estimates are reasonably stable. By using appropriate technical methods, auto-correlation of residuals may be corrected.

IAN SENIOR (*The Economists Advisory Group*): I was particularly interested in what Professor Frey had to say about innovative contracts. I have far more faith in the concept of contracts, rather than rules made by a constitutional body. I would ask for his comment on an idea I am putting into a book.

The election manifestoes of parties contesting an election should be costed and the manifesto of the winning party should become a legal contract between that party, the government, and the state and the citizen. I offer two very clear-cut advantages of this system. The first is that it would be an immediate curb on the growth of money supply and inflation because the figures would be absolute, so that if the government simply printed paper, as it tends to do these days, it would diminish its real spending power.

Before those who have had anything to do with government hold up their hands in horror and say this cannot be done, let me say there is a precedent, not in the United States, not in Switzerland, but in a less-developed country called the United Kingdom, in its local government. If a local authority exceeds its bounds in expenditure, any member of the public may complain to the district auditor, part of the central bureaucracy, who will hear the case in quasi-judicial surroundings. I have done it myself. Therefore the precedent exists. It has been imposed on *local* government by the central bureaucracy. I would ask Professor Frey whether he would foresee a possibility, as I do, that this control of over-expenditure could be extended to *central* government?

PROF. FREY: That is indeed an innovative constitutional contract and I find the idea very attractive, but I cannot evaluate it now.

PROF. ALAN PEACOCK: In Table 2 (p. 105), on the influence of economic variables on government popularity, the popularity of the government does not decline as much in Germany as in the UK or US as a function of the rate of unemployment. Professor Frey offered as an explanation that this effect was due to the German fears of inflation relative to unemployment. How far is the 'guest-worker' a complication here? After all, it is possible to export unemployment problems physically in Germany. Also, I don't know whether the 'guest-workers' have votes.

Secondly, I assume, by what Professor Frey is saying about the political cycle, which he thinks is a bad thing, that the implication is that if you did not have a political cycle the amplitude of business cycles would be worse. If you examine the usual measures of the amplitude of cycles and compare the UK with other industrial countries, their amplitude is smaller.

PROF. FREY: With the guest-workers, that is a very good point. I know that from Switzerland. We would probably have 6 per cent unemployment. In practice, we have zero per cent, because we export unemployment and it is therefore no problem. The same applies to Germany.

PROF. WISEMAN: I have some worries about the way the political cycle models are specified. First, the factors that affect popularity. Should we be concerned with the outcome of policies? Are people affected by what happens in the economy, or by what the government is doing, or appears to be doing, about the economy? These two are different, unless we make the assumption, which seems to me highly implausible, that the outcome of government policies is the one that it predicts for them. Unless it is so, we have to distinguish between popularity as affected by what *happens* and popularity as affected by the *appearance* of government action.

Associated with that question, and as a part of it, how do we get what could be called 'popularity lags' into the system? If it is the reality that affects behaviour, then the kind of data you are using is right, so far as it is a part of the awareness of the voters at the time. But the problem in the kind of sequential model you are using is that if people are affected by the data, and there are lags in the outcome of policies then, even if governments can do what they pretend they are doing, it may be the action in the second year after the election that produces the outcomes that are influencing voters in the year before the next one.

From this point of view, it seems to me that it has got far more than the normal econometric problems, both in specifying what influences popularity and then identifying the action that causes the thing to happen that does so influence it. My feeling is that none of the models deals with this problem.

PROF. BUCHANAN: I would like to make a comment on what Jack Wiseman has just said. There are several problems here. First, you may have governments thinking they can do something about it, trying to do it, and being unable to do anything about it. And certainly into this general discussion ought to be drawn a point of view, with some empirical testing, that is now very popular in the United States amongst economists —though I don't happen to accept it at all. This is the so-called 'rational expectations' view which, carried to its extremes, says the government cannot do anything, because if it is known to be trying to do something people will anticipate what it is trying to do, they will act rationally in so doing, and it will have no effect whatsoever. The government therefore can do nothing.

PROF. FREY: I used this 'rational expectations' idea when I introduced social learning. Once people understand that there is a business cycle that is created for political purposes it can no longer be produced by government because people react against it through their voting or some other political activity. I think that is a very interesting way of getting rid of this political business cycle.

I quite agree with what Professor Wiseman said. The econometric testing of such highly aggregated functions is a severe problem, especially with the lags, but there have been some attempts to differentiate between what the government *does* do and what it *can* do or *could* have done. Research results suggest that people find it too difficult to differentiate between these two things. They are simply happy when unemployment is low, whether it is due to good government policy or to some other influence. They do not differentiate between the two.

OLIVER STUTCHBURY: I began by thinking that the hypothesis Professor Frey was discussing was that if governments were efficient, there would be political business cycles. I thought he demonstrated to us pretty conclusively that it was false to suppose there were political business cycles. This would suit me very well because I think it is false to think that governments are efficient.

Having reached this conclusion, it seemed to me he presented the evidence to show that there was a political business cycle after all. I did not see anything which persuaded me that there was one, and I remain convinced that governments are inefficient.

MAX HARTWELL (*Chairman*)**:** It may be that you will have to wait and read Professor Frey's article in the *Economic Journal* (June 1978) for the evidence.

PROF. FREY: It is true that I did not show the econometric estimates because they are detailed and complicated. My view is that, although government is not terribly efficient, it does know reasonably well how to create a political business cycle, how to steer the economy at the right time and to undertake an expansionary policy. In England, of course, unlike other countries, government can in addition decide when to have an election. So here there is a two-way interaction.

MORRIS PERLMAN (*LSE*): On the assumption that the government is efficient in creating a political business cycle, there is a lot of evidence that fine tuning of the economy over the last twenty or thirty years has not been very successful, and the Treasury in its prediction model has not been terribly successful in the United Kingdom for the last few years. Therefore, even if one accepts the theory that the government *wants* to create a political business cycle for electoral purposes, what one should examine is not the *outcome*, because that depends on the lags between policy and outturn of policy and on the government's ability to predict the effects of its policy, but the *instrument* that the government uses in practice to create the particular outcome. So, even though it might be true that the electorate reacts to, say, unemployment and inflation, that is, the results to which they respond, the policies that the government will try to introduce—monetary policy, fiscal policy, and so on—at a particular time and then see whether it really affects unemployment and inflation at 'the right time'—the date of the election, then you have the problem of lags and the ability to predict. So I would like to see a relationship, say, between the date when the government introduces the policy, the policy itself not its results, the number of years before an election, and so on.

The rational expectations hypothesis does make your paper slightly different from most of the others in the sense that the argument is crucially dependent on the ignorance of the electorate. For the government, if its political business cycle is effective, is essentially fooling the electorate. If the electorate could foresee the same things as the government, and if it took its policy over the whole period of the government, rather than what happens in the first two years and the last two years—it would simply discount unemployment, inflation over the whole governmental period. There would then be no rational reason for the government to introduce an electoral cycle. Most of the other theories we have had today do not depend, at least so crucially, on the ignorance of the electorate.

PROF. FREY: You said that attempts at fine tuning have not been successful. That is a statement in the tradition of social welfare functions. Successful in what area? I have found that governments *are* reasonably successful in creating political business cycles. It is true they have not been successful in dampening the swings of the economy, but perhaps they did not want to. That is an important difference.

You suggest we look at instruments. We do explain the use of instruments, namely, consumption expenditure, investment expenditure, transfers, taxes, etc.; and then in one case we used a pure econometric model to trace through the effects of those instruments on the outcomes in unemployment, growth of incomes and inflation.

PROF. CHARLES ROWLEY: The implications of the popularity results, at face value, would suggest that government would be much more sensibly employed in looking after unemployment rather than growth, as the marginal relationship between unemployment and political popularity is very much more sensitive. It seems to me there is a possible danger with using the British growth rate data—you are very lucky to get a coefficient at all, since it has varied so slightly over the period under examination. The unemployment variable will have varied much more. If, for example, you had variability of the growth rate in the order of 6 percentage points in a year, you might get a very much stronger popularity result, a much higher coefficient on that popularity variable, than you would if it is moving between 1 and 1½ per cent per annum. You are getting that with the unemployment variable because you are getting a much greater dispersion.

JOCK BRUCE-GARDYNE, MP: If Professor Frey's thesis is correct for the UK, you would have expected to find governments able to use the methodology he has suggested to achieve regular re-election. We find over the last fifteen years in this country that no government that has survived more than two years in office has been re-elected. It also seems to me striking that, when the last Labour Government came to seek re-election in 1970 they claimed they had cured the balance of payments. The popularity of appeal of the balance of payments would not, to me, be immediately apparent. And it seems that the claim that the present Government is likely to make is, in some ways, even more bizarre for a Labour Government, that it has restrained the growth of the money supply. I would suggest that governments in the UK have, on the whole, behaved much more like Pavlovian dogs responding to the alternative stimulus of a high level of unemployment on the one side, and a balance-of-payments problem and all that that implies, on the other.

PROF. FREY: Both are in the model. Governments react to high unemployment because of the high popularity loss when there is high unemployment. I did not go into the balance of payments, because it is an economic restriction in our politico-economic model. But we did find it to be very significantly restrictive in the United Kingdom. But I think our model is fuller because it also has inflation and other variables in it. In other countries, for instance, in the United States or in Germany, the balance of payments is not a constraining factor at all. So we do find differences between countries.

CHRIS GOODRICH (*LSE*): I would like to reply to Dr Perlman's remarks by saying that, contrary to the accepted conventional wisdom of neo-classical economics, and contrary to the liberal democratic paradigm which seems to underlie most of the public choice analysis, such empirical studies as have been undertaken, both outside and through the popularity function analysis over a broad range of countries and time, have shown that the electorate tends to be myopic. It has an incredibly short memory, and tends to be remarkably ignorant of the state of economic affairs, let alone the state of political affairs.

This has two consequences. The first is for the possible remedies. The idea of social learning was canvassed by Nordhaus in his 1975 article.[3] He rejected it on the grounds that the average voter is not a sophisticated econometrician and that he is not able to evaluate the performance of the economy and project forward in time—to estimate the profile of the economy over the electoral term. Moreover, he is also not able to distinguish between government-induced actions and other influences upon the economy—for example, the consequences of international interdependence.

The second consequence is that, if these analyses are true, you have the behaviour of the electorate as postulated by the preference function, and if you have the democratic constraint upon government behaviour imposed by elections at periodic intervals, then you have a basic tension between efficiency in governmental management of accepted policy goals, the classic Keynesian goals, and democracy itself. This follows because the more democratic you make the system, the more likely you are to engender the forces which will generate the political business cycle. Such remedies as have been canvassed—lengthening the electoral term, for example—have brought out this dilemma in a stark form.[4]

NEVILLE BEALE (*Shell*): If I understood Professor Frey's statistics correctly, unemployment would be a very much more significant factor in increasing the unpopularity of UK governments than inflation. My empirical observation, knocking on doors in both the June 1970 and February 1974 elections, would have been quite the opposite. I do not expect to convince Professor Frey, but since in any period we may, in practice, find both the rate of inflation and the rate of unemployment increasing at the same time, how does he decide which is having the weightier effect on the increase in the government's unpopularity?

PROF. PEACOCK: A quick footnote about what instruments politicians would like to control and how. I have had a little experience here. What they would be interested in is the movements in some of these variables—

[3] W. D. Nordhaus, 'The Political Business Cycle', *Review of Economic Studies*, April 1975, pp. 169-90.

[4] E.g., C. Duncan MacRae, 'A Political Model of the Business Cycle', *Journal of Political Economy*, Vol. 85, No. 2, 1977, pp. 239-63, esp. p. 253; E. R. Tufte, *The Political Control of the Economy*, Princeton University Press, 1978.

unemployment, not least—in marginal constituencies. The difficulty, of course, is that you cannot do very much about the rate of inflation—no fine tuning can produce a particular rate of inflation in a particular constituency. There might be something you can do about unemployment. And the idea of Mr Goodrich, by implication, that somehow or other politicians should work on the assumption that the electorate is myopic and has short memories is not compatible with the way in which they act. Governments act as if voters *are* immediately responsive to particular acts of government policy in which you are trying to improve regional or constituency employment. I cannot offer you any proof of this proposition, except that I can say that I worked for one Minister with encyclopaedic knowledge of marginal constituencies down to the exact number of the majorities!

PROF. FREY: I very much agree with Chris Goodrich that voters are myopic. We have found in our econometric or rather polito-metric estimates that the time-period voters remember is very short. It does not usually go much further than one year in any country.

The technique for differentiating the influence of unemployment, inflation, and income growth is to run a multiple regression.

I completely agree with Professor Peacock that marginal constituencies are, indeed, the unit to study. I did say that these highly *aggregated* popularity functions are useful for some purposes and not useful for others. I think one should not use these politico-economic models for practical political manoeuvring—they are not suitable for it.

One instrument governments particularly like to use is transfer expenditures, like social cash benefits. Therefore, we did not use growth of national income but rather that of disposable income, which includes such transfers. We have found that transfers are, indeed, very heavily used in all countries as an instrument for creating political business cycles.

MAX HARTWELL: Thank you very much. I think that closes an extremely interesting session. As an historian I was brought up in the belief that since governments were relatively unimportant, particularly in the 19th century, they reacted to the business cycle. There is a famous article by W. W. Rostow, on the early 19th century trade cycle, which related the history of social protest and social legislation to the trade cycle in the form of 'a social tension chart'. I think it is a measure of the change in the function of government that we now think of it as *creating* business cycles, not as a passive *reactor* to them.

5. The Economics of Bureaucracy: An Inside View

ALAN PEACOCK
University College at Buckingham

The Author

ALAN PEACOCK: Principal-Designate and Professor of Economics, University College at Buckingham, since January 1978. Formerly Professor of Economics and Head of Department of Economics, University of York, 1962-77. Chief Economic Adviser, Departments of Industry, Trade and Prices and Consumer Protection, 1973-76. Member, IEA Advisory Council. Author (with Jack Wiseman) of *The Growth of Public Expenditure in the UK,* 1961; *Income Redistribution and Social Policy*, 1954; (with G. K. Shaw) *Fiscal Policy and the Employment Problem,* 1971; co-author (with C. K. Rowley) of *Welfare Economics: A Liberal Restatement*, 1975. For the IEA he has written: (with Jack Wiseman) *Education for Democrats*, Hobart Paper 25, 1964; (with A. J. Culyer) *Economic Aspects of Student Unrest*, Occasional Paper 26, 1969; *The Credibility of Liberal Economics* (Seventh Wincott Memorial Lecture), Occasional Paper 50, 1977; 'Trade Unions and Economic Policy', in *Trade Unions: Public Goods or Public 'Bads'?*, Readings 17, 1978. His collected essays, *Economic Analysis of Government*, are expected to be published in 1979.

ALAN PEACOCK:

I. INTRODUCTION

The Institute of Economic Affairs has paved the way in this country for the study of the economics of bureaucracy by its publication of the work of William A. Niskanen and Gordon Tullock [1] [2].[1] My own experience,[2] for what it is worth, suggests that their analyses rest on rather strong assumptions, though I recognise that they have provided a useful point of departure for this contribution.

II. THE THEORETICAL FRAMEWORK

The essence of the Niskanen/Tullock (N/T) approach is that there is a close analogy between the theory of the firm and the theory of bureaucratic operation. Though trained and treated like an élite, bureaucrats are not cast in some god-like mould so that their thoughts and actions can be deemed superior to those of other persons. They maximise their utility, subject to constraints. They, too, sell their skills, by providing technical and administrative advice to producers of government policies, i.e., to politicians in power. It is true that they are precluded from maximising money profit, as does the archetypal entrepreneur, and they produce nothing for direct sale; but their sources of satisfaction are similar to those in other occupations. In Niskanen's words (which we shall recall later):

> 'Among the several variables that may enter the bureaucrat's motives are: salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau. *All except the last two* (italics mine) are a positive

---

[1] Useful expositions of economic theory of bureaucracy by British authors are in Charles Rowley, 'Efficiency in the Public Sector', in Colette Bowe (ed.), *Industrial Efficiency and the Role of Government*, HMSO, 1977, and Keith Hartley, *Problems of Economic Policy*, George Allen and Unwin, 1977, Ch. 11.

[2] As Chief Economic Adviser, Department of Trade and Industry (later Departments of Trade, Industry, Prices and Consumer Protection) from 1973 to 1976. The Chief Economic Adviser in these Departments is a Deputy Secretary, jointly responsible for the management of five Divisions headed by a statistician or economist of Under-Secretary rank. In my time the total strength of these Divisions was about 500.

function of the total *budget* of the bureau during the bureaucrat's tenure.'[3]

So, fortunately for the mathematics of the argument, the bureaucrat's 'maximand', the element he tries to maximise, can be reduced to a measurable quantity, for his motivation leads him to maximise the size of the bureau's budget.

The important proposition which N/T are anxious to establish about this kind of behaviour is that it leads to 'over-production' by the bureaucrat. The entrepreneur in a competitive market is induced to produce an amount which is optimal from the consumers' point of view, firstly, because he is forced to minimise costs in order to survive and, secondly, because, at the margin, the costs of production are equated with the price consumers are willing to pay. However, the bureaucrat is more in the position of a monopolist. He is the sole supplier of particular administrative and technical services; moreover, and no less important, he is the sole source of information about his costs of production. The entrepreneur in the competitive market can only extract the minimum sum consumers are willing to pay for his product, but the bureaucrat can extract the maximum sum which the purchasers of his services are willing to pay. As economists would put it, this allows him to equate total costs with total benefits instead of marginal costs with marginal benefits. However, as the bureaucrat is precluded from maximising profits, he 'captures' the total budget by pushing output *beyond* the competitive optimum to conform with his desire to enhance his prestige and power.

The conclusion of interest for government policy is that, if all bureaucrats act in the way described, there is waste of resources in producing government services which can be avoided only by methods of improving bureaucratic efficiency. Niskanen[4] considers such methods as competition between bureaus, altering the reward system for bureaucrats (e.g. bonuses to 'top' officials) in order to encourage economy in resource use, turning over production to private firms (e.g. refuse collection), and facilitating investigation of government departments by 'watchdog' committees of the legislature.

Are bureaucrats dominant and politicians 'passive adjusters'?

If Niskanen's argument has substance, it may be asked why politicians supplying public funds must really be assumed to act as passive

[3] *Op. cit.*, p. 22. [4] *Op. cit.*, Ch. IV.

adjusters to the actions of bureaucrats, for if all bureaus behave in this way somewhere along the line the suspicion of being 'taken for a ride' must occur to politicians. In seeking to answer this question, several economists have turned their attention to the motivation of those social and political groups who 'bargain' directly or indirectly with bureaucrats.[5] Indeed, their studies are designed to employ public choice theory in such a way as to explain the most important economic phenomenon about modern government, the growing proportion of annual resources to which it lays claim, with the bureaucrat playing a crucial role.

The argument can be summarised, rather baldly, in the following way. Voters do not pay directly for government services and their individual tax payments may bear little if any relationship to the benefits which they may derive from such services. They have every incentive to maximise their gains from government services and will vote for politicians who will facilitate access to them. Incumbent legislators, faced with potential and (at election time) actual competition from other political parties, can beat off challengers only by promoting the services which voters want at apparently no cost to them. Legislators are therefore strong supporters of bureaucratic organisations which supply these particular services, such as education and health. They will not inquire too closely into the possibility that there may be 'fat' in bureaucrats' budgets, particularly if bureaucrats help their constituents materially by giving them government jobs, by being generous in their interpretation of regulations governing the allocation of subsidies, and so on.

As the public sector expands in response to the short-term common interests of the groups active in the political market-place, a larger proportion of the working population acquire a vested interest in government employment, and form also a larger proportion of *voters*, thus re-inforcing the process of government expenditure. The process will be self-defeating in the sense that voters will be faced with growing tax burdens; but no group in isolation has any incentive to reduce its demands for supposedly free government services and therefore no brake is applied to stop the expansion of the public sector.

[5] For example, Thomas E. Borcherding (ed.), *Budgets and Bureaucrats: The Sources of Government Growth*, 1977, and also Alan Peacock and Jack Wiseman, 'Approaches to the Analysis of Government Expenditure Growth', *Public Finance Quarterly* (forthcoming).

III. A CRITIQUE

The first problem I face in matching this analysis with personal experience is that of identifying the bureaucratic decision-maker. He is by definition in charge of a budget, authorised to bargain with a 'supplier' of funds, that is, over its amount and composition, and to be at least formally accountable for how the funds are used. If this is the case, then in the UK it would be entirely misleading to identify Niskanen's 'bureaucrat' with senior civil servants. The appropriate person is the Ministerial head of a Department of State who presents his annual estimates in the first and crucial instance to the Chancellor of the Exchequer for approval, but with right of appeal to the Cabinet, a body of which he is normally a member. What must now be investigated is whether a Minister will act differently from N/T Man and whether the limitations on his doing so are different.

Components of a Minister's utility function

If I had to guess at the components (or 'arguments', as the economics profession calls them) in a Minister's utility function, I would say that he 'trades off' political ambition within the Government against the perceived benefits to him of party loyalty. I have argued elsewhere [3] that the first of these components leads Ministers to seek control of policy instruments which dramatise their actions. In all probability a Minister will regard maximising his budget certainly as a sufficient, but not a necessary, condition for achieving this end. Clearly, more expenditure enables him to extend the range of instruments which become associated with his Ministry and therefore with himself. Altering the composition rather than the amount of the budget may have too high an opportunity cost, e.g. the personal 'wear and tear' in arguing with officials and others with a vested interest in existing policies, particularly in a profession in which the future is discounted very heavily ('a week is a long time in politics', according to Harold Wilson). I have seen Ministers argue for hours in favour of budget adjustment to suit a change in the 'policy mix' but only under the threat of rigid 'cash limits' collectively agreed by the Cabinet and imposed by the Treasury Minister.

The second component in the Minister's scale of preferences places a brake on too singleminded a pursuit of budget maximisation. The costs to the party in power of granting an increased budget to an ambitious Education, Housing, Transport or other Minister are the alternative uses of tax receipts to promote party aims; it cannot always be assumed that all proposed increases in Departmental estimates can be covered simply by tax increases, particularly as such increases themselves may produce a 'backlash' effect which might weaken the long-run support for the party.

Incidental references I have made to the political environment in which politicians as bureau chiefs maximise their aims, point to further doubts about the applicability of the N/T analysis. Ministers as bureaucrats cannot act as discriminating monopolists, at least in the UK, even if they wanted to. They cannot afford to obstruct probing into their programmes by the Chancellor of the Exchequer through Treasury officials when they are in competition for funds. They may be the sole suppliers of particular services such as nuclear power, postal services, broadcasting, etc., and may find malleable officials who can exaggerate the costs of producing them, but, in terms of the ultimate aim of retaining power, few services are not substitutable at the margin for others.[6]

The second difficulty with the N/T analysis follows from the first. What does the bureaucrat (defined as a public official) maximise? In the UK, Administrative Class civil servants are normally appointed on the assumption that they will spend by far the major part of their working life in government and will obtain job security early in their career. (The position is similar in France and Germany.) They are relatively well paid and pensioned alongside those with comparable educational background, age and experience in the private sector, and a move into the private sector by a senior civil servant before retirement is news. This contrasts markedly with senior public officials in the USA. Few top officials have tenure, there is a high degree of mobility between the private and public sectors which is aided by the ability to trade a reputation for energy and 'go' in either sector.

[6] A well known fallacy in economics is to suppose that the sole seller of separately identifiable produce or service necessarily has monopoly power. Studies of industrial concentration which base their findings on *types of product* rather than on market shares have to be interpreted very carefully. Monopoly can only be defined in terms of *market power*, i.e. the sensitivity of the quantity demanded of a product or service to a change in its price. For example, a visit to a concert is a substitute for a dinner in a restaurant as well as a substitute for another concert or a visit to the theatre. All these activities are competing ways of deriving satisfaction (utility) from an evening out.

In the kind of professional environment surrounding the British higher civil servant (say, Deputy-Secretary and above), one would be surprised if utility maximisation could be summed up in maximising the size of the bureau to the exclusion of other factors. Though the distinction cannot be tightly drawn, it is useful to distinguish between those who are primarily concerned with the *formulation* of policy for Ministerial consideration and those concerned with the *execution* of policy.

(i) *Policy formulation*

Take policy formulation first. Though it frequently involves officials in quite junior posts (including technical staff, e.g. economists and lawyers), it is essentially the principal concern of those who have reached the top, the Permanent Secretaries. How do they achieve this exalted position? This is a complex question to answer, but as a cockshy I would suggest that they do so by maximising their reputation within their professional cadre. They are picked for the 'fast stream' at a relatively early age because they appear potentially able to combine two highly-prized qualities within their cadre: the clarity and persuasiveness of their drafting and their speed in designing and assembling the machinery for a policy 'exercise' and putting it into operation. Military terminology of this kind is only rivalled by cricketing analogies in civil service parlance. Briefs for Ministers are designed to help him bat on 'sticky' Parliamentary wickets, the deadline for their delivery usually being 'close of play' (circa 1800 hours). Indeed, one abiding impression I have is that designing and assembling the 'machinery'—often an elaborate *ad hoc* committee system sometimes spread across several Departments—is frequently considered as more important than what the machinery is supposed to produce.[7] In the words of the song popularised in the 1930s by that delicious US 'songbird', Alice Faye: 'It ain't what you do, it's the way that you do it. That's what gets results.'

Thus, while maximising one's reputation within the professional

[7] After writing this I came across an intriguing statement by George Pottinger, the senior Scottish civil servant imprisoned for his part in the Poulson affair. Talking of Poulson he writes (*The Scotsman*, 22 April, 1978): 'He found strange my assertion that civil servants had no politics and there was nothing a good civil servant liked more than a change in government and the chance to look at policies from the opposite point of view.' This is a clear indication of the intellectual attractions which go with policy formulation.

cadre is entirely compatible with a desire for prestige and power, and with more laudable motives such as a wish to serve the nation, maximising one's budget is neither a necessary nor sufficient condition for achieving it. The most prestigious positions in the Civil Service are still in the Treasury, a Department of government principally concerned with the efficient use of resources, both public and private, and where officials do not make the obvious mistake of pursuing this aim by maximising the amount of 'fat' in their own budget.

(ii) *Policy execution*

It is true that so far as heading up exercises in policy formulation, it is a case of many being called but few chosen. The job specification of a large proportion of senior civil servants is principally determined by the need to execute policies devised by superiors and approved by Ministers, though they may be responsible for offering 'feed back' on the effectiveness of the policy instrument which they must operate and consulted on possible improvements. It is difficult to believe that a significant number of them, who have been denied the power which goes with promotion to the highest echelons or who have foregone the chance of promotion having viewed with concern the incidence of heart attacks among their peers, do not maximise a very different utility function in order to enjoy the ease associated with long experience in working established routines. Certainly this impression would accord with the common man's view of the bureaucrat.[8,9]

---

[8] As epitomised in the splendid line in Louis Macniece's cynical poem, *Bagpipe Music*: 'sit on your arse for fifty years and hang your hat on a pension'.

[9] In his *Bureaucracy* (1945), which is surprisingly sympathetic to his subject matter, Ludwig von Mises regards the pursuit of ease as the essential difference between European and US bureaucrats: 'In a properly arranged civil service system the promotion to higher ranks depends principally on seniority. The heads of the bureaus are for the most part old men who know that after a few years they will be retired. Having spent the greater part of their lives in subordinate positions, they have lost vigour and initiative. They shun innovations and improvements. They look on every project for reform as a disturbance of their quiet. Their rigid conservatism frustrates all endeavours of a cabinet minister to adjust the service to changed conditions. They look down upon the cabinet minister as an inexperienced layman. In all countries with settled bureaucracy people used to say: "The cabinets come and go, but the bureaus remain".' (p. 70) He adds the intriguing suggestion that able intellectuals might still be attracted by a bureaucratic career if only because of the leisure it would allow to pursue their talents as writers or artists!

'On-the-job leisure'

The kind of 'model' which I am in the process of developing out of my own casual empirical investigations would identify at least two aims in the bureaucrat's utility function, the bureaucrat being, say, the head of a Division, normally with Under-Secretary rank. He would certainly derive utility from the emoluments and the power and prestige going with the management of skilled administrators, but he would trade this off against the utility of what I shall call 'on-the-job leisure'. The larger the number of administrators he has to supervise, the more time spent on 'man management' and the less time available for such on-the-job leisure activities as 'eating for the Queen' (diplomatic lunches, dinners of professional societies) and attending prestigious national or international conferences (preferably only as an observer where formal attendance can be minimised). Where trade-offs are constrained by difficulties in adjusting the workload, then the appropriate instrument of the skilful 'satisficing' bureaucrat is delegation to carefully picked juniors. A senior member of the Foreign Office as a young man on his first overseas appointment tells the story that he reported to his Ambassador at 11 a.m. as ordered. The Ambassador informed him that he would be expected to be in his office by 11 and to stay at least until 3.30. The young diplomat inadvisedly remarked that this regimen seemed congenial. 'What?' said the Ambassador, 'I suppose you could put it that way, but you must agree that it does rather cut into one's day'!

Niskanen, as we have seen, specifically excludes 'ease of managing a bureau' from the factors which lead bureaucrats to maximise their budget. At the same time, there is nothing in the utility maximising behaviour of our bureaucrat which would lead him to make the size of his budget conform to something like the competitive optimum. His deviation from the optimum is unlikely to manifest itself in 'over-production'; it is more likely to take the form of 'producing' output at well above minimum cost. (Economists would call this 'X-inefficiency' as distinct from 'allocative' inefficiency.) This is because 'on-the-job leisure' normally requires complementary expenditure such as expense allowances and other perquisites of office. His 'desired' budget will certainly be higher than that which would be necessary to conform to the competitive optimum but his 'satisficing' behaviour will place a limit on the investment in time, energy and skill he would be willing to devote to maximising it. In short the N/T model, while employing strong assumptions about bureaucratic behaviour, lends itself to further development, along lines parallel to the development of the study of entrepreneurial behaviour which has grown out of the earlier literature in which profit was the sole element in the entrepreneur's structure of preferences.

IV. CONCLUSION

Finally, I must relate what I have said to the attempts, previously mentioned, to examine the role of bureaucracy in the political process. It follows from my analysis that I am not convinced that the senior civil servant plays the positive role assigned to him in promoting the growth of public expenditure as a means of helping his masters retain voter support. I have taken part in too many exercises where senior civil servants have tried to persuade Ministers of the incompatibility of their lavish extensions of spending programmes with longer-term, less vote-catching objectives to believe that. Indeed, it is worth remarking parenthetically that there is much to be said for the 'ganging up' of officials in the manner which aroused the wrath of Crossman—and arouses that of Benn—and for the associated intelligence network as being the only way in which officials can bring Ministers to the point of decision and to accept collective responsibility.

No incentive to reduce public *vis-à-vis* private sector

On the other hand, my examination of the motivation of civil servants lends no support to the proposition that they should be fervent advocates of a reduction in the size of the public sector relative to the private sector. Doing a 'good professional job' requires only that Ministers can be persuaded to act consistently in relating their political aspirations to the resources available. It offers no incentive for bureaucrats to restrict the policy tools available by foregoing expansion of the public sector. Nor are promotion prospects enhanced by formulating schemes which drive close colleagues into early retirement, reduce the chances of advancement of younger colleagues, and risk confrontation with the major civil service unions. Anyone who took this line of action would be soon exposed as taking a strong political position offering him only the grim alternatives of retraction, resignation or removal to some departmental Siberia. A positive and influential action by bureaucrats to reduce public sector growth could follow only from mass resignation at the top. I see little prospect of that.

REFERENCES

[1] Niskanen, W. A., *Bureaucracy: Servant or Master?,* Hobart Paperback 5, IEA, 1973.

[2] Tullock, Gordon, *The Vote Motive,* Hobart Paperback 9, IEA, 1976.

[3] Peacock, A. T., 'Giving Economic Advice in Difficult Times', *Three Banks Review,* March 1977.

Discussion

ROY HOUGHTON (*University of Sheffield*): I once heard a senior civil servant, now an outstanding figure in the financial world, in answer to a student's question as to how different it is working for a Conservative Government on the one hand and for a Labour Government on the other, reply as follows: 'Well, there are some things it is easier to get done under a Conservative Government and there are some things it is easier to get done under a Labour Government'. This reply suggests there is an alternative policy which the Civil Service puts into operation in an order determined by the electorate. I wonder if Professor Peacock has any comments?

PROF. PEACOCK: I speak with little experience but I have never seen such a list. It is well known from Ministers' memoirs that incoming governments are met with documents prepared by senior officials which turn their Party manifestoes into a kind of feasibility study. Sometimes quick thinking is needed by officials if they make a wrong forecast of the election result! These documents are the only kind of 'list' I have been concerned with.

PROF. BUCHANAN: We have all been informed by Professor Peacock's paper, but I would like to defend those economists who have never had any experience.

Experience can be helpful, but also damaging, in the sense of making it difficult to step back, take a proper perspective and try to analyse the situation quite independently of the close-upness of the experience. There is much to be said for the main thrust of the argument that there are, of course, other things that motivate bureaucrats than budget maximisation. His argument about x-inefficiency—that bureaucrats produce whatever they produce at a much higher cost—is, I think, a weakness in this part of Niskanen's 'model'. But the crucial element I am missing in the Peacock 'model' is any help towards explaining governmental growth, which he acknowledged he was also interested in. At least the Niskanen/Tullock models do, in fact, try to get some handles on that task.

PROF. PEACOCK: I agree that experience can be damaging and can affect one's perspective, but intense commitment of any kind can be equally damaging. Having said that I believe I share many of Professor Buchanan's value-judgements.

It is perhaps a little unfair to draw me on the broader question of the link between bureaucratic activity and government expenditure growth because this question is not studied in detail by Niskanen and Tullock. They use a partial equilibrium model, and the contrast they draw between entrepreneurial and bureaucratic behaviour is interesting and valuable. Their model has to be extended to produce the general equilibrium type of system which enables us to account for growing government expenditure—along the lines for example suggested by Noll and Fiorina.[1] I have here only hinted at this approach.

I would add that when we examine the transactions between voters, bureaucrats and politicians we find very good examples of 'the isolation paradox'. Everyone seems to favour a cut in the public sector, but nobody has any incentive to do anything about it. Civil servants may agree that their departments could be cut in half without doing much damage, but they are not anxious to lose their jobs. Voters may individually support stricter rules over payment of unemployment benefit, but are not going to incur unpopularity with their fellow-voters by advocating this in public. The interesting question is: At what stage does the system 'blow up' because of the intolerable burden of taxation? Precisely when do preferences change so markedly that the kind of constitutional rules suggested by Professor Buchanan, rules which will govern the relationship between taxes and benefits, can be introduced into realistic political discussion?

To return to the government bureaucrats: I have argued that greed for resources does not fit with their utility functions. That is not to say they are devoted to reducing the number of tasks of the public sector. They are conscious of waste. Let me give a counter-example to Professor Breton's

[1] Roger G. Noll and Morris P. Fiorina, 'Voters, Bureaucrats and Legislators', *Journal of Public Economics*, No. 3, 1978.

suggestive remarks about tariff policy. His view does not fit with my experience. After all the sophisticated arguments one can adduce against tariff protection, Ministers may still not be convinced; but if you tell them that tariff measures will require five hundred more civil servants they are forced to take notice!

JAMES MACMILLAN: Would Professor Peacock agree it is the alliance of the academics and the Civil Service which has given rise to the enormous increase in the numbers and the power of the Civil Service? In the days when the academics had a proper humility, immediately after the war when Churchill took over, the Civil Service declined in numbers. Then with Harold Macmillan and the Three Wise Men,[2] so-called, we got the enormous increase, so that there are almost double the number of civil servants today that there were at the end of Churchill's régime.

Now, as we are all trade unionists today, will Professor Peacock give a solemn pledge that he will black all academics from joining the Civil Service?

NEVIL JOHNSON: I thought some of Professor Peacock's more anecdotal evidence corresponded very closely with mine about fifteen years ago. I saw in the Press that the new budget requires the employment of 1,200 more civil servants but equally, I believe, the Inland Revenue is not particularly keen on taking them on.

PROF. ANDRESKI: On Professor Buchanan's question, I would have thought that in his light-hearted but very penetrating way, Parkinson has given an answer. From my observations of hierarchical organisations of all kinds, I think the pressure for expansion usually comes from the people who want promotion, not people who have already arrived at positions which they regard as satisfactory. In University expansion, those who are the fondest enthusiasts are usually assistant lecturers and so on, not even vice-chancellors necessarily.

There is another aspect: giving jobs to aspirants to any kind of white-collar occupation. And there are some cases in America, much more extreme than anything that could have been seen in Britain, where giving jobs in the civil service to all kinds of unemployed people was a very significant electoral promise. It was known that people who helped the party to organise an electoral campaign would expect jobs in the civil

[2] The members of the Council on Prices, Productivity and Incomes, set up by Mr Harold Macmillan in July 1957, were originally Lord Cohen (chairman), Sir Harold Howitt and Sir Dennis Robertson, who resigned in December of that year and was replaced in February 1958 by Professor Henry Phelps Brown. In May 1960, Lord Cohen was replaced by Lord Heyworth, and Sir Harold Howitt by Sir Harold Emmerson. The Council produced four reports before it was wound up in March 1962.

service. So I think there are some other mechanisms which do not necessarily operate inside the civil service but from outside.

GORDON RICHARDS (*Hammersmith & West London College*): I speak as one of the most expensively employed unemployables masquerading as a lecturer in a college of further education. I do not think I am distinguished in this regard from many others here. Why are we afraid to tackle this vast, expensive, scandalous bonanza masquerading as education? It is the biggest single waster of public money. And would this even be electorally unpopular? The people who benefit from this scandal are the middle classes who do not yet, I understand, comprise the majority of the population. The working class, who pay for the bonanza, get very little out of it. So I would have thought any politician or party that had the courage to say, 'We are going to reduce the school-leaving age to fourteen and then eventually to twelve', would stand to gain a lot of votes.

MAX HARTWELL: At this stage the discussion moves to a panel: a variety of people, mostly not professional economists, who will comment on the relevance for their subject of the economics of politics or public choice.

PART III

Panel Commentaries

by

NEVIL JOHNSON

KEN JUDGE

HENRI LEPAGE

ROBERT GRANT

PAUL WHITELEY

The Authors

NEVIL JOHNSON: Nuffield Reader in the Comparative Study of Institutions and Professorial Fellow, Nuffield College, Oxford. Author of *Parliament and Administration: The Estimates Committee 1945-65*, 1966; *Government in the Federal Republic of Germany*, 1973; *In Search of the Constitution*, 1977.

KEN JUDGE: Lecturer in Social Administration, University of Bristol. Author (with J. Matthews) of *Rationing Social Services: A Study of Resource Allocation in the Personal Social Services*, 1970; *Charges in the Personal Services*, 1977.

HENRI LEPAGE: Research Officer, Institut de L'Entreprise, Paris. Vice-President, Association de l'Economie des Institutions. Author of *Demain le Capitalisme*, 1978; *Autogestion et Capitalisme*, 1978.

ROBERT GRANT: Lecturer in Business Studies, City University. Studied economics at the London School of Economics, taught at the University of St Andrews, then worked for the Monopolies Commission before taking up his present appointment. Main research interests lie in government policy towards private industry. His publications include editing (jointly) and contributing to a textbook on UK economic policy, *Current Issues in Economic Policy* (1975), and articles on industrial economics in the *Scottish Journal of Political Economy*, the *Bulletin of Economic Research*, the *Journal of Business Finance* and *Accountancy*.

PAUL WHITELEY: Lecturer in Politics at the University of Bristol; formerly a lecturer in the School of Economics and Politics at Kingston Polytechnic. His research interests are in empirical political theory, particularly electoral behaviour. His publications include: 'Bayesian statistics and political recruitment', *British Journal of Political Science* (1976); 'The structure of socialist ideology in Britain', *Political Studies* (1978); 'Electoral forecasting from poll data: the British case', *British Journal of Political Science* (1979); and he is editing a volume on political economy to be published (by Sage) in 1979.

Politics and Economics: Interdependence and Basic Differences

NEVIL JOHNSON
Reader in Comparative Studies of Institutions, Nuffield College, Oxford

Basically, what we have been talking about are the relationships between economics and politics: relationships, that is, between the goods-producing system in society and what political scientists usually call the political system.

There are, of course, various ways in which we can describe the political system more concretely: we could refer to the rules, procedures, habits and customs by which a variety of decisions affecting the whole society in one way or another are made in a binding fashion, these together constituting the political order. The question which this basic theme—the relationships between political practices and modes of economic activity—throws up is this: if one talks about the economics of politics, government, bureaucracy, etc., is there not a danger of concluding too easily that we can construct an account of political relationships, and a theory of how the political system works, which treats the political system as analogous to the goods-producing system constituted by the economic arrangements of the society? I am doubtful whether this analogy can or should be pursued too far.

Five comments

There are five points I would make. First, what we may call the power-maximisation assumption underlying in particular Professor Breton's remarks, and in that connection the relevance of authority. Next, demand compression as a task or aspect of the role of government, and then equality, particularly equality of rights in a distributive sense, which is an aspect of the whole subject. Finally, the broader issue of the relationship between economics and politics will be taken up briefly.

(i) *Power-maximisation*

First, the power-maximisation assumption. It seems to me, as a student of politics, that it is in practice a rather difficult one to accept. It seemed to underlie a large part of Professor Breton's discussion. Presumably the analogy here must be with the motive to maximise the enjoyment or possession of goods, and the argument appears to be that in political relationships and in governmental activity people are seeking in a similar way to maximise their power. This does not seem to me to be really plausible, though I appreciate that a few notable political thinkers have argued otherwise. I do not think it is plausible on analytic grounds. Since power is a relational concept, I doubt whether in the last analysis one can talk about maximising it.

Neither do I think that it really can be demonstrated in empirical terms that people in political life and in government are always concerned with maximising their power. Professor Peacock and others have shown this clearly by considering what appear to be the motives inside the bureaucratic part of the governmental system. If one were trying to explain why, in the expansion of the bureaucratic services of government in Western European countries over the last 10 years, the expansion is much larger in education and health and one or two other social support services, I do not think we could demonstrate empirically that this has been attributable to any large extent to the urge of politicians and bureaucrats to magnify their empires, in other words, to magnify their power, their budgets, and so on. I am not implying that such motives as increasing empires are completely irrelevant, but it does not seem to me that one can demonstrate that it is decisive.

(ii) *Power and authority*

Second, an aspect of the problem of power and authority. Certainly the question that the political scientist is much more concerned with is: How do politicians maintain their authority? It would, of course, be rather difficult to talk about them maximising their authority, although it makes very good sense to talk about them maintaining it. Authority means the right to act and the capacity to maintain some respect in a complex society for that right to act. That ties in, of course, very aptly with the American song Professor Peacock referred to. This lady was on to a point of very considerable importance for the student of politics: 'It ain't *what* you do, but the *way* you do it'. Whether she was empirically correct in saying that it always gets results is another matter, but at any rate she was pointing to one of the major issues with which the analyst of political relationships must be concerned.

On this question of authority we face a big difficulty or paradox. It is obvious that in any society, and particularly so in Western society nowadays, in which undoubtedly people have come to believe that governments exist to produce goods, the very act of trying to produce goods may diminish a government's authority because of its lack of success. It may diminish authority and a capacity to maintain respect for this entitlement to act because of the conflicts it arouses, satisfying some needs rather than others.

It may diminish authority also in a much more impalpable way, because our heritage of political concepts—there is an enormous time-lag here—reaches back into a distant past. These values rest upon loyalties, habits and expectations which have little to do with 'productive efficiency'. And this suggests that people do not necessarily judge politicians and bureaucrats exclusively in terms of the output of goods they guarantee. Their authority is not derived primarily from their output-producing capacity, although this is not to deny that the goods output is an important consideration on many occasions.

(iii) *Demand compression*

Third, demand compression. I suggest an issue which is closely connected with the analogy between the economic system and the political system. In the economic system on the whole—forgive me if this is a naïve remark from a non-economist—we are concerned with maximisation of production of goods. Adam Smith called his book *The Wealth of Nations*, and one of the ideas there was that wealth could and should be increased. Yet the politician cannot really be concerned in a straightforward way with the maximisation of the availability of goods. On the contrary, if he is prudent he will often be concerned extensively with the ways in which the demand for goods of different kinds—they need not necessarily be material goods—can be reduced or restrained. And there may be convincing reasons on his part for acting in this sense: his own capacity to survive, to do his job, to maintain his authority and so on, may depend on skilful demand compression.

(iv) *Equality of rights*

Fourth, rights and how we conceive them. In a long historical perspective, most of our justifications and most of the theorising about rights have been in terms of procedural rights: people have entitlements to be treated in certain ways. The emphasis now seems to have shifted. In the modern world we tend to see rights not only in these terms, but to a very large extent in terms of entitlements to a *share* of goods, indeed to *equal* shares of goods.

This shift in thinking about rights and their application puts an enormous strain on the political system. It makes demand compression very much more difficult for governments because they exist in a context in which there is an insistent demand for a much more equal distribution of goods. In addition, this emphasis on equalising the shares—the rights in this sort of distributive sense—diminishes the belief in the society that it can achieve these ends by mechanisms other than some public arrangement, some public planning and direction. In other words, the criticism of the market as a means of satisfying 'needs' stems to some extent from the positive evaluation attached to the claim to more equality in the distribution of goods. So you have a dynamic pushing towards this continual extension of the public sector.

(v) *The 'separateness' of economics and politics*

Finally, the relationships between the economic system and the political system. If we look back historically over the traditions of liberal constitutional political thought, it seems to me that on the whole they have been concerned to see political life, structures and institutions, procedures, behaviour, customs and practice in terms of means by which we can facilitate the settlement of problems in society by the people chiefly affected by them. The liberal tradition was, of course, also concerned to legitimate various kinds of public decision, but more important was the maintenance of a situation in which individuals, whether singly or collectively, could to the maximum practicable extent resolve problems themselves.

This whole tradition of political thought and practice has laid strong emphasis on the procedural nature of politics and political institutions. There is certainly a link with the particular body of economic ideas and thought we have been considering today. This link is provided by the fact that classical and neo-classical economic thought has also been concerned with providing theoretical justification for arrangements under which the satisfaction of needs can be achieved in society on a basis which maximises the opportunities of choice on the part of the individuals in society. The underlying problem is to devise and justify in political terms institutions which will at any rate increase the prospect of maintaining an economic system which will serve those purposes. There is an inter-dependence of economic and political arrangements, yet neither sphere is reducible to the other.

That is the fundamental point I want to emphasise: public choice theory must acknowledge the separateness of economics and politics, whilst demonstrating how a congruence between the two can be achieved.

Producer Groups and Social Welfare

KEN JUDGE
Lecturer in Social Administration, University of Bristol

My task is to say something about the importance of public choice for the study of social administration.

Social administration is a strange rag-bag of a subject concerned with the study of all aspects of social policy. Fundamentally, social policy is no different from any other kind of public policy and, as I believe the new political economy or public choice approach is valuable for all students of public policy, it follows that it ought to be useful to those who study social administration.

There are many areas where the public choice approach can illuminate important questions in the study of social welfare, and I will mention two of them; but there are also aspects of public choice which might limit its ability to attract a wider audience.

Welfare state growth and income redistribution

One of the most significant features of the welfare state in the United Kingdom in the post-war period is its growth. Social services seem to have an insatiable appetite for additional finance. The second aspect is that public choice analysis can help one to understand the true nature of the redistributive, or non-redistributive, impact of spending on the social services.

Relatively little attention has been paid to the first question, but I think that Professor Albert Breton's book[1] and others in the public choice tradition provide a very useful framework for examining the growth of public expenditure on the social services. In particular, they draw together many familiar factors on the demand side, such as citizen preferences for service provision at given tax prices. In many ways, however, perhaps the most important aspects of public choice analysis are those which highlight the importance of factors on the supply side that facilitate over-expansion of state spending. Professors Breton and Peacock have mentioned the Borcherding

[1] Albert Breton, *The Economic Theory of Representative Government*, Macmillan, London, 1974.

volume on *Budgets and Bureaucrats*,[2] which raises interesting questions about the extent to which bureaucrats and other public employees, either directly or indirectly, can over-supply public services. Unfortunately, some of the claims made in the literature are rather extravagant. The Borcherding book, for instance, includes some discussion about the testability of hypotheses on the role of bureaucracies in promoting excessive expenditure. An attempt is also made to develop a bureaucratic power index which assumes that if the proportion of the population on the public pay-roll exceeds a critical threshold it will have an expansionary effect on the supply of public policies. Although we can easily accept these ideas as interesting speculations, the only firm evidence to support them is an isolated example drawn from Austin in Texas in 1933.[3]

The public choice challenge

Nevertheless, the public choice approach has a lot to offer students interested in understanding the growth of the welfare state in the UK and elsewhere Equally it can help us in the way we approach thinking about public expenditure more generally. I think—although I may be putting myself into hot water here—that what has almost characterised British social administration is the belief that public expenditure is intrinsically good. The public choice approach encourages us to challenge that assumption not only in activities like defence, or transport, or law and order, or other traditional government services where social administrators might criticise public expenditure, but also in health care and education and other social services where it is becoming clear that many of the so-called benefits, if there are benefits, of welfare expenditures leak out to the producer groups providing welfare services in both the government and private sectors. The implications for policy of the distortions which can arise in the supply of social services are that we should reconsider traditional pricing solutions, not so much to raise finance for social services, but to increase consumer participation. Unfortunately, too many social administrators have an antipathy for the price mechanism and the merits of charges are conveniently ignored.

---

[2] Thomas E. Borcherding, *Budgets and Bureaucrats: The Sources of Government Growth*, Duke University Press, 1977.

[3] Rosco C. Martin, 'The Municipal Electorate: A Case Study', *Southwestern Social Science Quarterly*, December 1933.

I have three comments on the weaknesses of the public choice approach. First, the individualistic behavioural postulates upon which the public choice approach rests are not accepted by many non-economists and, therefore, it seems to me of critical importance to develop what Professor Wiseman called (p. 80) a theory of group behaviour. Second, one of the most important factors in explaining public policy, but which has been neglected, is that of political advertising. Professor Meade spoke (p. 65) about the extent to which consumer needs are moulded by suppliers in the private market, and that is no less true in the public sector. There is some literature about preference adjustment, and Professor Breton mentioned the extent to which politicians, bureaucrats and other public employees engage in political advertising (and some of Professor Buchanan's colleagues have written likewise), but it remains an aspect which few have considered and we should develop that literature further.

'Simplistic assumptions' about motivations

Third, the present set of simplistic assumptions about the motivations of producer groups, such as bureaucrats in the Civil Service, does more harm than good in trying to convince people of the utility of the public choice approach. Professor Buchanan attempted (pp. 00-00) to persuade us that it is less important to develop testable propositions in the public choice mould than to develop sophisticated but plausible theories. I am convinced that is the correct approach. But, if it is, we require a much more realistic appraisal of the motivations of all public employees. Both Professor Peacock (pp. 119-128) and the discussion (pp. 128-131) focussed almost entirely upon higher civil servants. We should recognise that the American literature upon which we draw is highly culture-bound. We should extend the analysis to all public employees, not only bureaucrats. We must, in particular, examine the institutional arrangements which permit public employees to influence budget growth.

I take two examples. It is essential to consider the way in which information is biased in the public sector, what Professor Randall Bartlett calls 'Information Pricing'.[4] We have not mentioned one of the most dynamic elements in the growth of the public sector—the local authorities. Local public employees, such as Directors of

[4] Randall Bartlett, *The Economic Foundations of Political Power*, Free Press, New York, 1975.

Social Services, have an influence on patterns of spending, and in recent years have been significant actors in expanding the volume of social welfare expenditure. Similarly, we must not ignore the way in which even the humblest employees, through trade unions and pressure groups, can influence public policy indirectly. All producer groups engage in political advertising by preparing reports of one kind or another to commissions and inquiries, as well as for more general consumption. This activity has the effect of stimulating the demand for their products.

Public Choice and the 'New Economists' in France

HENRI LEPAGE
Institut de l'Entreprise, Paris

There is very little empirical work on public choice in France. In a short work last September, Jean Claude Laffay, of the University of Poitiers, tried to estimate who was going to win the last French general elections. He started with a correlation study between macro-economic data, the evolution of the popularity index of French Prime Ministers, and the outcome of previous elections. He failed to forecast the relative success of the present majority, but one interesting feature of his 'model' is that he identified a time-lag of three terms for a change in unemployment to have an influence on voting behaviour, but only one term for price statistics. This largely explains the economic policy of M. Raymond Barre, the French Prime Minister, during the pre-election period and his refusal to allow an increase in demand, as everybody wished. Whether or not he knew about Laffay's model, he behaved in the way it suggested he should, i.e. to stand fast on prices and inflation.

A second work, more significant on scientific grounds, is a recent book by Philippe Cazenave and Christian Morrisson on *Justice and Redistribution.* M. Cazenave is teaching at the University of Rennes, and M. Morrisson is a professor at the Ecole Normale Supérieure, and also deputy director of ISMEA, the François Perroux Institute. Their book tries to develop a positive analysis of social justice in European countries, using a kind of public choice framework, and data on government transfers. It is, to my knowledge, the only work in France which tries to explain the growth of government transfers with a model of 'demand' for public goods using the framework of methodological individualism and group behaviour.

Absence of public choice analysis in France

The relative absence of public choice in French universities and research centres can be explained by the traditional attitude of our economists. The majority dreams of a new economic theory which would get rid of *homo economicus.* In their mind, further progress in the knowledge of the functioning of our society can come only from sociology, psychology, anthropology, and so on, not from a new breakthrough in the use of economic tools applied to new kinds of activity.

Yet there are interesting developments. The first is the appointment of Professor Jean Jacques Rosa at the Institut d'Etudes Politiques de Paris (where he teaches a course in micro-economics) as the head of a post-graduate programme leading to a PhD which will in part be specialised in public choice. Work has started on the theory of bureaucracy applied to hospitals, on the influence of welfare payments on the demand for government goods, and on the 'demand' explanation for the growth of government.

The second development is the rediscovery by French sociologists of the concept of individual rationality. Here I would refer to the works of Michel Crozier, Raymond Boudon and Jean Daniel Raynaud, who make intensive use of game theory to explain social inequalities in education, or the dynamics of labour conflicts. Raymond Boudon is launching a new series of books which will at last include French translations of the works of Anthony Downs and Mancur Olson. It is not yet true public choice analysis, but it is a major step towards introducing plainer economic tools into the study of French social problems.

AEI—a French IEA?

The third development is the birth of the 'Association pour l'Economie des Institutions' (AEI). Our hope is one day to become something close to your own Institute of Economic Affairs, while trying to tap more public and private funds for the financing of university programmes dedicated to the study of human capital, property rights and public choice. We have already organised a conference on 'Why Government Grows', attended by Professors Alan Meltzer and Walter Eltis. The next meeting, scheduled for June 1978, is on the 'Economics of Regulation'. And the 1979 conference will deal with the economics of social transfers. We are also promoting the translation of IEA papers such as Milton Friedman's *From Galbraith to Economic Freedom* and Gordon Tullock's *The Vote Motive*.

Finally, among the books currently published in a short period by what we call 'les nouveaux economistes' are several which aim at initiating the French public into the micro-economics of social institutions. They include *L'Economique retrouvée* by Jean Jacques Rosa and Florin Aftalion of the Ecole Superieure des Science

Economiques et Commerciales; *Sauver l'Economie* by André Fourçans of the same school; and an excellent textbook, *La gestion des ressources humaines dans l'entreprise*, by Henri Tézénas du Montcel (Université Paris Dauphine) and Yves Simon (CESA). Another important book is *Les nationalisations, a quel prix, pour quoi faire?*, by Georges Gallais Hamonno of the University of Orleans, published last summer. M. Gallais Hamonno is the first French economist who has tried to test the relevance of the property rights theory using a sample of French nationalised firms. His results are what we might expect and close to what Professor Jack Wiseman has told us about the British nationalised sector: low profitability, over-production, 'social advantages', etc.

Year of the 'new economists'

1977 was the year of the 'nouveaux philosophes'. Thanks to the help we have received from the Institut de l'Entreprise, and also because of the political debates of recent months, 1978 is going to be the year of the 'nouveaux économistes'. We are not yet many, but by grouping ourselves within the Association pour l'Economie des Institutions, by popularising the label 'Les nouveaux économistes', and by editing an academic joûrnal called *Vie et Science Economiques*, it seems we are having an influence on ideas in both business and government circles. Our main media—weekly newspapers, magazines—are giving a wide coverage to our essays and ideas. My book, *Demain le Capitalisme,* is a best-seller—30,000 copies have been printed which, in France, is very large for a book on economics. We therefore conclude that the demand for market economics in France is growing rapidly. Something has changed since the elections. Prospects are better than they have been for a long time, and we hope to be able to take advantage of it to introduce more public choice and property rights analyses.

In a country where 90 per cent of research in the social sciences is government-financed, and where the allocation of public finance is mostly in the hands of people who favour non-market economics, our first task is one of information and education, so as to make Frenchmen, particularly politicians and business men, more aware of the new potentialities and frontiers of economic research. In four or five years' time a number of French economists will be in a position to address you about their own works.

The Economics of Politics and the Deficiencies of UK Economic Policy

ROBERT GRANT

Lecturer in Business Economics,
City University

As an applied economist, I am particularly interested in the light which the economic analysis of politics and government sheds upon the choice of economic policies by government.

The chief deficiencies of economic policy in the United Kingdom appear to be:

- the tendency to reflation before general elections (examined by Professor Frey);
- the desire to maintain a level of demand in the economy above that consistent with stable prices;
- the design of policy measures to appease the most politically influential sectional interests (notably trade unions and big business);
- the tendency to replace markets by bureaucratic decision-making;
- the tendency for economic policy objectives to be inconsistent, reinforced by the creation of policy agencies which pursue conflicting strategies.

Rules restraining government are unsatisfactory

On the basis of the papers at this Seminar, the economic approach to political choice and bureaucratic behaviour offers considerable insight in dealing with these deficiencies. Yet if such 'models' are to be useful either in providing illuminating descriptions of the political process or, more importantly, in generating valid predictions, they must, as Professor Peacock has suggested, pay regard to the realities of the organisation and structure of the decision-making process within the political-bureaucratic system.

If the economic approach to the analysis of government and politics is useful in explaining and predicting the choice of economic policies by government it should also be capable of suggesting remedies for some of the failures of economic policy. Professor Buchanan in his paper suggested constitutional constraints upon government in Britain. He argued that during the latter part of the

19th century economic policy in Britain was formulated within the unwritten rules of free trade, the gold standard and balanced budgets. Recently it has been contended that monetary policy in the UK should be taken outside the discretion of government and be subject to constitutional rules.[1]

It seems to me that the imposition of written or unwritten rules upon economic policy is an unsatisfactory method of avoiding the pursuit by successive governments of short-term political advantage at the expense of the long-term health of the economy. The adherence by British governments to traditional rules has been a major source of errors in economic policy in the past. The return to the gold standard in 1925, the desire to maintain balanced budgets during the inter-war period, the adherence to a fixed, over-valued exchange rate during the decade before 1967 are examples.

Information for government

While legal restraints offer a direct means of limiting the discretionary power of government over the economy, there are less costly methods available for directing economic policy closer towards the interests of society as a whole and, in addition, improving the efficiency of the formulation of policy. One such means is to increase the flow of information to and from government on economic policy. In his neo-classical analysis of political decision-making, Professor Breton raised the question of imperfections in the bargaining mechanism. It would appear that imperfections in the flow of information are a potentially important source of imperfection in Professor Breton's model. The control over information exercised by government then represents a potent mechanism for the creation by government of discretionary power over economic policy. The increased generation of information to the electorate was explicitly identified by Professor Frey as a means by which government could be discouraged from generating the political business cycle.

It would appear that improvements in the flow of information to and from government could have a general effect in improving the quality of economic policy. First, increased information from government concerning the policy process would allow the assumptions and forecasts made by government to be subject to more formal

[1] J. M. Buchanan, John Burton, Richard E. Wagner, *The Consequences of Mr Keynes*, Hobart Paper 78, IEA, 1978.

review which might encourage policies to be more efficient in meeting their goals. Second, by providing to all the access to government deliberations on economic policy which at present is restricted to privileged groups, government might be encouraged to direct its economic policies more towards the interests of society as a whole and less towards those of bureaucrats and interest-groups.

This process, to be effective, requires the development of bodies outside government which can provide expert analysis of government policies, actual and proposed. To this end the further development of independent, policy-orientated research centres must be supported.

Public Choice: A Dissenting View

PAUL WHITELEY

Then Lecturer in Economics and Politics, Kingston Polytechnic; now Lecturer in Politics, University of Bristol

I am an empirical political scientist who is particularly interested in the relationship between the state of the economy and electoral behaviour. The paper which came closest to my research was by Bruno Frey, but I would like to comment on public choice as a whole.

Public choice economics is very stimulating and very important for the future of political science. The model building approach in the public choice literature points the way forward in political science, but some aspects of this approach I find arid, and I think are up a blind alley. This is increasingly true of the Arrow tradition of the analysis of collective action assuming individual ordinal preference functions of unrestricted domain.[1]

Far from the real world

The original Arrow theorem, the 'impossibility' theorem, was a very important result, as emphasised by Professor Buchanan and others. But of the hundreds of papers being produced on this theorem, many are essentially trivial. They do not take us further into understanding real-world processes of collective decision-making. In examining some of this formal literature, one is reminded of the medieval debates among theologians about the number of angels which could be placed on the head of a pin. Some of this literature illustrates the general danger in social science, and indeed natural science, of becoming too far removed from the real world, and from the healthy constraints of empirical testing. Many aspects of public choice are very fruitful and give rise to hypotheses of great interest, but I think this is a valid criticism.

[1] Arrow's work was concerned with the relationship between individual and social preferences where the latter are aggregated from the former. Arrow showed that if individuals rank-ordered their preference for social states (e.g. tax/benefit combinations) then, providing no restrictions were placed on possible orderings and other reasonable conditions were met, no agreed social ordering could be obtained by majority voting. This was a very general and important result. Much of the subsequent work is merely an elaborate footnote to it. (K. J. Arrow, *Social Choice and Individual Values*, Wiley, New York, 1951.)

To some extent the public choice literature ignores the big issues which face social scientists in the world today. The main question, which amounts almost to a paradigm crisis in economics, is the decline and fall of the market.[2] Wherever one looks in Western societies today, whether in education, social welfare or health, the private market is on the retreat as a system of allocation. Until quite recently economists thought of their subject as something almost exclusively concerned with market allocation. It was no accident that the journal *Public Choice* was originally called 'papers in non-market decision-making', as if economics was really about market decision-making and public choice theory examined exceptions to it. The analysis of non-market decision-making is still the central concern of public choice, but the literature lacks an adequate analysis of why the market is in retreat. Only Professor Peacock's paper examined this issue.

Theories of market retreat

In general there seem two types of explanation in the economics literature for this phenomenon. The first is exemplified by Milton Friedman, in his recent lecture at the University of Strathclyde.[3] This might be dubbed the 'hand-wringing' theory of market decline; there is no explanation of why it happened, but much hand-wringing over the fact that it has.

The second, and much more interesting, and which I think Professor Peacock clarifies, is the idea of a paradox of collective action. This is a generalisation of the Olson paradox,[4] named after Professor Mancur Olson of Maryland University. It argues that tax-payers and the recipients of government benefits are not the same people and, since these two roles are divorced, individuals will demand increased government intervention and spending without realising the costs, or without having to pay for it themselves. This paradox can give rise to an irresponsible demand for a growth in bureaucracy and public expenditure. Although this approach is interesting it does

[2] The term 'paradigm' is used in the same way as by Kuhn to mean a 'coherent tradition of scientific research'. (T. Kuhn, *The Structure of Scientific Revolutions*, University of Chicago Press, Chicago, 1970, p. 10.)

[3] 'Has the Tide Turned?', Inaugural Hoover Foundation Lecture at the Strathclyde Business School, reproduced in *The Listener*, 27 April, 1978.

[4] M. Olson, *The Logic of Collective Action*, Schocken Books, New York, 1968.

not of course explain national differences in market allocation. The market has declined to a significantly larger extent in Europe than the United States, for example. Nor does it explain differences in the rate of change of market decline over time. The 1945-50 Labour Government, for example, achieved a quantum jump in non-market allocation in the UK. To explain these phenomena it is necessary to use concepts which economists have traditionally ignored or been hostile to, such as ideology, power and social class.

Political power and the market

I think one major explanatory factor in the decline of the market has been the demands of the organised working class who rightly or wrongly have concluded that they were getting the worse of the deal in market allocation. Consequently they have used their voting power to vote down the market. Such a phenomenon makes a nonsense of the formal results on Pareto optimality derived from market models of collective action.[5]

The importance of such sociological concepts as class can be seen in the recent work of Professor D. A. Hibbs[6] on the political economy of strikes. Hibbs showed that countries with social democratic or democratic socialist régimes have, historically, experienced significantly fewer man/days lost in strikes than democratic countries without such régimes. His interpretation of the causes of this difference lies outside traditional neo-classical theorising. He argues that strikes are essentially indications of the class struggle between labour and capital. A social democratic régime mediates this class conflict by channelling working-class political activity into the governmental

---

[5] A Pareto optimal allocation of resources is such that no other possible allocation can improve the welfare of one individual without reducing the welfare of another. This notion has attracted much interest because it provides an ideological justification for market allocation; it can be shown in an abstract model that a market system produces a Pareto optimal outcome in welfare terms. However, if one introduces the notion of class conflict at the centre of the resource allocation problem, this result no longer holds. In this case allocation is best analysed in terms of a complex hierarchical N-person game involving ideological, sociological as well as economic considerations. Outcomes will reflect comparative power resources in an extended class struggle. The market merely reflects underlying class-power relationships.

[6] D. A. Hibbs, 'On the political economy of long-run trends in strike activity', *British Journal of Political Science*, 8, Part 2 (1978), pp. 153-76.

arena, away from the purely industrial arena. This work is in my view an example of political economy at its best.

Rationality in conflict and uncertainty

A third general issue I would like to raise concerns the nature of the assumptions made about individual rationality which underlies much economic theory. Very often economists make very naïve assumptions about individual rationality when what we ought to be doing is to examine how people go about making decisions in real-life situations of conflict and uncertainty. I thought Professor Wiseman's paper on the nationalised industries particularly weak in this respect. I find it difficult to see the value of deducing a set of social roles attributed to public sector managers from a set of *a priori* principles. It seems to be obvious that we should be trying to examine empirically the decision-making processes in the public sector and also the private sector in order to determine the differences between them. It is perfectly true that a manager in the public sector is not merely trying to optimise one variable, profits, but rather several variables subject to several constraints. But the same is true of the manager in the private sector. Ascribing efficiency in the private manager to a mythical notion of profit maximisation when he is also subject to varying objectives and constraints does not take the discussion much further.

Empirical testing of motivation and behaviour

By the same token, the discussion on the motivation and behaviour of senior civil servants was not very helpful. Much more in the way of opinion surveys and behavioural analysis of decision-making élites is required before generalisations can be made about the role of civil servants. I am not saying it is invalid to make *a priori* deductions, but such approaches have to be closely related to empirical testing to be fruitful.

I have been working on the subject of Professor Frey's paper—the political business cycle—for some time now, examining the influence of aggregate economic variables such as unemployment and inflation on voting behaviour. One of the problems of estimating this influence in relation to General Elections is that we have to study a fairly long period, the whole of the 20th century, in order to have enough observations. If we try to relate short-term changes in aggregate economic variables before elections and support for the governing or opposition parties, there do not appear to be any significant relationships. Such estimates incorporate variables which take account of major changes in the political system in the UK over time. This makes me rather sceptical about the evidence put forward by Professor Frey. I have seen other evidence on the Scandinavian countries and Japan to suggest non-existent or weak relationships between political support and economic conditions.[7]

Importance of voters' perceptions

These results suggest that the important factor in political support is probably voters' *perceptions* of their economic well-being, rather than actual well-being. What people perceive and what is actually happening are rather different and may at times be wholly inconsistent. This refinement further reinforces the argument for attitude surveys. In the political science literature the evidence from voting surveys suggests that one of the best predictors of an individual's voting behaviour is his/her parents' voting behaviour. Very often the floating voters who decide elections are the least informed and the most likely to switch allegiance for reasons, such as the image of the leadership, unrelated to party performance. The survey evidence supports the distinction between actual and perceived economic performance. Thus any simple 'model' which has the electorate rewarding or punishing an incumbent political party for its actual economic performance is not consistent with known characteristics of electoral decision-making.

My own view is that the existing rational choice literature is a much better model of *party* strategy than it is of *voter* strategy.

[7] Evidence on the relationship between aggregate economic variables and political support for a variety of countries is to be published in a reader: P. Whiteley (ed.), *Models of Political Economy*, Sage, London, 1979.

Summing Up

MAX HARTWELL (*Chairman*): The conference comes its full cycle. We started with Professor Buchanan—we finish with Professor Buchanan, and it is his task to sum up.

PROF. BUCHANAN: Many issues were raised by the Panel that had not been discussed earlier in the conference.

Although the title is 'The Economics of Politics' or 'The Economic Approach to Politics', which we in the USA call 'Public Choice', basically the people who are working in the subject, by and large, are economists. Some have called this 'economic imperialism' because we are straying from our usual role of trying to explain individual behaviour and institutions through market processes, and extending this methodology and this use of the analysis to explain non-market decision-making.

In that sense, much of what has gone on in this body of literature, this developing body of analysis, discourse and dialogue, has involved economists talking to one another. Many of the criticisms that have emerged here and elsewhere have been from people who are really not within the framework of this discourse. They probably were somewhat discouraged because they did not fully sense many of the nuances of the arguments that were going on among the economists.

There have been several aspects of this attitude.

Critique of orthodox economic theory

First of all, implicit in much of today's discussion was a critique of economic theory itself, of orthodox conventional economic theory, as it has been developed over thirty years and to an extent that is peripherally related to public choice, but is not a direct part of public choice. I am talking particularly about Professor Rowley's critique of welfare economics. Some of the formalism of that structure is extended a little in Professor Wiseman's discussion, i.e. the disregard of structure, and of institutional aspects, the attempt to make things more objective than they really are and to get away from individual choices.

This is an argument I think inherent in the development of economic theory today and it is important; I would not neglect it. It is not directly germane to the economics of politics, but it is connected very dramatically to it. To summarise that argument, this central critique of economic theory: orthodox conventional economic theory over the last half century has, I think, over-stressed allocative efficiency as opposed to the structure of institutions. There is now a sign of a return to the Adam Smith type of emphasis on the structure of institutions out of which results emerge. It is not the results that we should be so interested in but the institutions that produce the emergent outcome.

As Professor Robert Nozick puts it quite well, in his book *Anarchy, State and Utopia*—I think he discusses this subject better than anybody else—the emphasis is now on processes rather than on instates. That is a very critical distinction, a sort of within-house, within economic theory, discussion.

Secondly, many of us in the public choice or economics of politics tradition criticised economists for having neglected to apply some of their intellectually and aesthetically satisfying models of rational behaviour, with predictive content at least in the theory of markets. We are criticising economists for not having extended these analyses to political or non-market processes. In a sense economists, along with other social scientists, have gone on what I have called the 'bifurcated man' assumption: that man behaves in one way in the market-place and he becomes somebody else when you shift him into another capacity. He is many things, but it seems to me there is some predictive value in extending the same models we have found to be useful in the theory of markets over into the other capacities in which men behave.

Third, there has been implied criticism of political scientists and other social scientists for not having developed more satisfactory models of the political process. That criticism goes back to the criticism of imperialism by economists. It is an extension of our type of approach into activities where we have not previously been involved but have left it more or less to the political scientists and others. Hence the unfortunate split of political economy into two parts in the last century. I think political science traditionally has, over the last century, shifted more and more into a somewhat descriptive-type, non-analytical approach.

Fourth, and perhaps most importantly, I would like to say in summing up that the economic theory of politics, of public choice, is not a criticism of politicians or bureaucrats. That is obvious, but I think it requires emphasising. There is no presumption in these models or in this approach that politicians and bureaucrats are any different from the rest of us. It is not an 'evil man' assumption. There is no implication at all that politicians and bureaucrats behave any differently from other people. There is no implication that they are grabbing, self-interested, maximising, squeezing, any more than you or I or anyone else.

We can incorporate in utility functions all of these arguments and we can develop logical structures which yield some understanding and some empirical predictions. I think many economists who follow the empirical side are guilty of trying to plug in measurable economic values, dollars or pounds, in those functions, and this quantification tends to bring the old narrowly-defined 'homo economicus' to the fore, when that should not be the case.

I am willing to accept from Professor Meade and others that many people in their capacities as bureaucrats or as politicians try to do their best to further what they conceive to be the public interest. But that is exactly also true in the market-place. If you ask a business man what he is doing he will not tell you he is out to maximise profit. He will tell you he is doing things in the public interest. There is no difference here.

Positive and normative analysis of institutional structures

Let me conclude by saying that what I was trying to get at in my opening lecture was another distinction: between positive and normative. Before we can begin to think about structure—political structure, economic structure—we have to have positive analysis of the way alternative institutional structures work. In one sense it is a return to institutional economics: the study of the institutional structures, individual behaviour within those structures, and prediction of outcomes which emerge under those structures.

In that case, we must have, first of all, positive analysis of the way these structures work. We also must have, looking down the road apiece, what I call normative understanding, a normative evaluation. The most important part of all is to get people to think about structure. Then I think we are half way home. I think that is beginning to happen. The most encouraging thing to me about these two days in this conference was a remark Lord Robbins made to me this morning when he said 'The whole discussion of constitutional structure, and the possibility of constitutions, is now a very hot topic in Britain today'. If that is empirically correct, it is a very important statement. That is what I will take home as the most important part of this meeting, though to discuss it meaningfully we have to have analysis and consider alternatives.

PART IV

Two Views on Bureaucracy

Modern: *WILLIAM A. NISKANEN*

Classical: *MARTIN RICKETTS* on ADAM SMITH

1. Competition Among Government Bureaus*

WILLIAM A. NISKANEN
Professor of Economics,
University of California, Berkeley, 1972-75

*Paper presented at the Annual Meeting of the American Association for the Advancement of Science, Washington, DC, 14 February, 1978.

The Author

William A. Niskanen, Jr.: Professor of Economics, Graduate School of Public Policy, University of California, Berkeley, 1972-75. Formerly Rand Corporation, 1957-61; Institute for Defense Analysis, 1965-70. Assistant Director for Evaluation in the Federal Office of Management and Budget, Washington, 1970-72. Author of *Bureaucracy and Representative Government*, 1972. For the IEA he has written *Bureaucracy: Servant or Master?*, Hobart Paperback 5, 1973.

WILLIAM A. NISKANEN:

I. INTRODUCTION

Maybe I should first describe my own preferences: One of my favourite fantasies is a dream that Washington might once again be a quiet southern town with several major shrines and minor universities and where everyone, other than tourists, has the good sense to leave town in the summer. My favourite prescription to balance the budget is to turn off the air conditioning in Washington as a symbol of the government's commitment to conserve energy. My dream, alas, is not likely to be realised in the near future and, in the meantime, it would be useful to improve the responsiveness and efficiency of the organisations supplying the many services we seem to expect from government.

One of the many manifestations of academic parochialism is the difference in views concerning how economic activity in the private and government sectors should be organised. Most economic departments still teach that competition among profit-seeking firms supplying similar products is desirable to achieve responsiveness to consumer demands, efficient supply, and incentives to innovate. Some economists confuse competition with the number of firms in an industry and some antitrust laws confuse competition with the preservation of weak firms, but there is a broad consensus that competition is both a natural and desirable characteristic of private markets. And the empirical evidence provides overwhelming support for this consensus. At the same time, most public administration departments, based on a literature of German sociology and Wilson's presbyterian maxims, still teach that monopoly bureaus are desirable to achieve responsiveness to the political authorities, the co-ordination of similar government services, the elimination of redundancy and overlap, and all those presumably good things. Aside from the few public administration scholars who have done empirical research, there is a broad consensus that government services should be supplied by functionally-specialised monopoly bureaus. The periodic attempts to reorganise government bureaus into functional monopolies, however, suggests that monopoly is not the natural condition of a bureaucracy. And there does not seem to be any empirical evidence to support the view that monopoly is a desirable characteristic for the supply of government services.

Most scholars seem not to have noticed this difference in views.

Some venturesome scholars have noticed the difference, but have proceeded to do their own thing in deference to the sensitivity over 'turf' in the academic community. Could both groups be correct? Is it plausible that business men and bureaucrats are such different people that profits are a necessary incentive in private firms but that the 'public good' is a sufficient incentive in government bureaus, that competition is a necessary discipline in private firms but that monopoly is a desirable characteristic of bureaus? Only a few scholars have even expressed any curiosity about these issues.

II. A SIMPLE THEORY

Some years ago, I sketched out a theory of bureaucracy and representative government, based on the central, radical assumption that bureaucrats and politicians are basically similar to the rest of us mortals (maybe even more so).[1] In general, they are assumed to value income, perquisites, power, prestige, the public good, and an easy life in roughly the same proportions as other people. The formal model of a bureau is based on an assumption that bureaucrats try to maximise the budget of their bureau, subject to the constraint that, on the average, they must supply the level and quality of service expected by the politicians. The politicians, in turn, are assumed to prefer re-election but to have no special concern about public issues that do not bear on their re-election. A bureau makes the initial budget proposal and is assumed to know the cost of supplying a service. Some set of the politicians determine the level of the budget but are assumed to have no special information on the cost of the service.

This model generates the following general conclusions:

- For a given demand for a government service (as revealed by the politicians), the budget of a bureau is too large, i.e., larger than the budget that maximises the net benefits of the service.
- The amount of the excess budget increases as a function of the

[1] William A. Niskanen, *Bureaucracy and Representative Government*, Aldine-Atherton, Chicago, 1971, and *Bureaucracy: Servant or Master?*, Hobart Paperback 5, IEA, London, 1973; also my 'Bureaucrats and Politicians', *Journal of Law and Economics*, Vol. XVIII (3), December 1975, pp. 617-43.

cost to acquire the same service from another bureau or a private supplier.

— The excess budget is spent on some combination of inefficiency and over-supply, the specific combination depending on the personal motivations of the bureaucrat and the reward structure of the bureau.

In the limit, thus, the excess budget of a monopoly bureau is limited only by the total demand for the service and by its own costs. Any alternative source of supply, even if it is not used, reduces the excess budget of a bureau by permitting the political officials to reduce the budget of a specific bureau without reducing the level of the service.

Monopoly bureaus: 'as majestic as the *Titanic*'

Some personal reflections beyond my formal model also bear on the role of competition in a bureaucracy. Competition among bureaus supplying a similar service increases the amount of information available to the politicians and the public, because the competition for budgets is forced to the political arena. A monopoly bureau, in contrast, is more effective in suppressing information about costs, failures, and risks. Competition among bureaus increases the range of technologies used to produce a service, reducing the risk of failure of a given approach and accelerating the evolution to a new technology when demand, production, and cost conditions change. A monopoly bureau is more likely to rely on a smaller range of dominant technologies. The consolidation of similar services in a monopoly bureau, by facilitating 'co-ordination', is likely to increase the range of outcomes, increasing the probability of doing everything right only at the cost of increasing the probability of doing everything wrong. And finally, competition among bureaus will appear messy, unco-ordinated, and lacking direction. A monopoly bureau, in contrast, may seem as trim and majestic as the *Titanic*.

Competition among bureaus is likely to be favoured by those who understand evolutionary processes and tolerate complexity. Monopoly bureaus are favoured by the medieval theologians among us who confuse co-ordination with direction, order with the organisation chart. Competition among bureaus, in summary, reduces costs, increases the potential for political control, and increases insurance against major failure. A messy organisation chart seems like a small price to pay for these effects.

III. SOME EVIDENCE

For those who care to look at the evidence, several types of empirical studies are now available that bear on the relation between bureaucratic structure and government spending. These studies suggest that the unit cost of government services increases with both the extent of monopoly and the absolute size of a bureau, and that the consolidation of similar services in a monopoly bureau significantly increases total spending.

Some sense of the effects of competition on governmental efficiency can be derived from a recent study of output per man-year in the federal government.[2] This study estimated the output and man-years for 114 elements of 17 agencies constituting 55 per cent of the federal work-force for five years from fiscal 1967 through 1971. The estimated annual percentage changes in the output per man-year from this study are presented in the table below.

INCREASE IN FEDERAL OUTPUT PER MAN-YEAR, 1967-71

Service/Activity	*Annual Percentage Increase*	
Final Services	1·25	
Operating		0·84
Processing		3·62
Support Services	3·24	
Management		1·32
Procurement and Supply		1·11
Maintenance		6·32
Industrial Services	5·38	
Overhead and Repair		5·05
Manufacturing		6·53

These estimates are almost perfectly correlated with the extent of existing competition among bureaus and with private firms. The federal government does not contract for any final services, and

[2] US Congress, Joint Economic Committee, 'Measuring and Enhancing Productivity in the Federal Sector' (Joint Committee print, 1972).

their output is difficult to compare across bureaus. The government contracts for some support services and for most industrial services. Among activities, the rate of increase of productivity is correlated with both the extent of contracting and the ease of comparing output across bureaus. The output measures are necessarily crude and the productivity estimates do not control for changes in other factors, but this pattern is too strong to dismiss. Bureaucrats, like other people, appear to shirk when they can get away with it and are efficient when they have to be. These estimates suggest the value of developing satisfactory output measures to permit contracting for final services and non-comparable activities with other bureaus or private firms.

Economies of scale in local government services?

Several studies of the economies of scale in the provision of local government services conclude that the unit cost of these services increases with the absolute size of the local government.[3] My own study of student performance in California public schools indicates that median scores on standard reading and mathematics tests at both the 6th and 12th grades are a significant negative function of school district size for districts larger than 2,000 students. Other studies of the school district size issue reach a similar conclusion. These studies control for family and community characteristics and for school expenditures per student but not for other possible outputs of the school system. Several similar studies of police performance conclude that police efficiency is a negative function of the size of the police district.

These studies are consistent with a conclusion that the efficiency of bureaus is a negative function of the size of both the government and the bureau. A larger government has more monopoly power, and the incentives of both voters and politicians to monitor the bureau are smaller. The costs of monitoring the bureau are larger, both to the politicians and the bureau chief, because the 'control loss' is a function of the number of managerial levels.

In summary, these studies suggest that inefficiency is not a necessary characteristic of the supply of government services. For a given output, these studies suggest that costs can be reduced by increasing the competition among bureaus, by contracting with private firms, and by reducing the absolute size of bureaus.

[3] 'Bureaucrats and Politicians', *op. cit.*, p. 636.

Federal bureaucracy: effects of reorganisation

The periodic reorganisations of the federal bureaucracy also provide an empirical base to test the effects of bureaucratic structure. These reorganisations, reflecting the conventional wisdom of public administration theory, have led to the consolidation of bureaus and agencies supplying similar services into larger departments. My theory suggests that the creation of these new departments would increase total spending for the consolidated functions. Several years ago, I tested for the effects on federal spending by function of the establishment of the departments of Defense (DOD), Health, Education and Welfare (HEW), Housing and Urban Development (HUD), and Transportation, controlling for the other conditions that have affected the spending by function.[4] The pattern of these results is generally consistent with the hypothesis that the establishment of these four departments increased spending. The coefficients on the departmental effect are generally positive, highly significant for the two largest functions (defence and income maintenance) and nowhere both negative and significant. The magnitudes of the spending increases associated with the establishment of DOD and HEW are substantial—around 34 per cent for defence, perhaps as high as 25 per cent for health, and around 25 per cent for income maintenance! There is no evidence that this type of reorganisation contributes to efficiency and economy. One wonders how soon Schlesinger's baby DOE (Department of Energy) will be overwhelmed by a herd of bucks.

The performance of these four departments, however, is even more disturbing than the increased spending. Since the establishment of the Department of Defense, the United States has fought one war to a draw against a second-rate military power, lost another war to a third-rate military power, and lost its strategic nuclear superiority over the Soviet Union. Since the establishment of HEW, health costs have rocketed, educational test scores have progressively declined, and there have been perennial demands for welfare reform. Following the establishment of HUD, our major cities have experienced riots, fiscal collapse and continued decay. Following the establishment of the Department of Transportation, a large part of the railroad system has gone through bankruptcy to nationalisation. Many other conditions, of course, have contributed to these problems, but there is no evidence that the establishment of these

[4] 'Bureaucrats and Politicians', *op. cit.*, pp. 640-43.

departments has reduced the developed problems in these areas. Somehow, I do not expect the Department of Energy to resolve the energy problem either.

Competition between bureaus

What is the alternative? Can we afford an unco-ordinated, redundant bureaucracy? My answer is there is an optimal positive amount of bureaucratic conflict and redundancy. It is very difficult to rationalise the combination of an anti-smoking campaign and tobacco subsidies, but these are trivial matters. The primary reason why some conflict and redundancy are important is that, in many areas, it is not clear what is the best thing to do. In many areas, competition among bureaus has been the primary reason why the government did something right, rather than everything wrong. Some of the more dramatic examples have involved the competition among the armed services in the development of weapons systems. In the hectic months following the launch of 'Sputnik' in 1957, the Navy launched the first US satellite, the Army developed the first intermediate-range missile, and the Navy developed the fighter-bomber that has been the backbone of the tactical air forces since that time; in each case, the Air Force had the assigned responsibility for these tasks. The competition between the 'Polaris' and 'Minuteman' missile systems accelerated the deployment, improved the quality, and reduced the vulnerability of both systems.

The continued competition between the Navy and Air Force to develop tactical aircraft and armaments has produced the best tactical aircraft systems in the world. The present competition between the Department of Labor, HEW and HUD has made it possible to make an intelligent choice among a jobs strategy, an incomes strategy and a cities strategy. Competition among bureaus may reduce the probability that the expected task is accomplished, but it increases the probability that the *right* task will be accomplished, often in unexpected ways.

IV. POSTSCRIPT

Competition among bureaus is the *natural* condition of a bureaucracy. Cartels among bureaus, such as the Key West agreement among the armed services, tend to break down under the pressure of changing conditions and budget constraints, unless re-inforced by the political authorities. Every new President, however, seems compelled to propose some consolidation of bureaus, and President Carter has made such reorganisation a major issue. (One of the more ironic elements of the Carter plan is to create a government monopoly of the authority to prosecute private monopolies.) President Carter will learn that government reorganisation is a tarbaby;[5] it involves a huge amount of time, energy and political capital to achieve, with little prospect of graceful withdrawal. More importantly, the consolidation of competing bureaus is the *wrong* type of reorganisation, even if it were easy to achieve. The President would be better advised to exploit the natural competition among bureaus—to elicit information, to assure different approaches to important issues, and to permit the use of budgetary sanctions and rewards to specific bureaus without changing the total budget for a given function.

My favourite fantasy may not be realised, big government may be around for some while, but there is no reason to tolerate a continued record of inefficiency and poor performance.

[5] A 'tarbaby', for the benefit of those deprived of the Uncle Remus stories, was literally a tarbaby, the creation of Brer Fox and Brer Bear to entrap Brer Rabbit.

2. Adam Smith on Politics and Bureaucracy

MARTIN RICKETTS
University College at Buckingham

The Author

MARTIN RICKETTS: Lecturer in Economics, University College at Buckingham. Formerly Research Fellow, Institute of Social and Economic Research, University of York, 1974-77; Economist, Industrial Policy Group, 1970-72. Winner of the Adam Smith Essay Competition (Junior Section) sponsored by IEA, 1976. Contributed articles to *Scottish Journal of Political Economy, Scandinavian Journal of Economics.*

MARTIN RICKETTS:

> 'I mean not however, . . . to throw any odious imputation upon the general character of the servants of the East India Company, and much less upon that of any particular persons. It is the system of government, the situation in which they are placed, that I mean to censure; not the character of those who have acted in it. They acted as their situation naturally directed, and they who have clamoured the loudest against them would, probably, not have acted better themselves.'[1]

The work of Adam Smith, written more than two centuries ago in political, social, industrial and technological conditions so different from those of the present day, could hardly be expected to yield easy answers to the problems of the modern world. Many issues of consuming public interest, such as trade union power or pollution control, were unknown to Adam Smith. Others, such as the provision of public goods or the organisation of the social services, have 18th-century parallels which are not irrelevant but dwarfed by the scale and technological context of modern counterparts. Nevertheless, fundamental aspects of Smith's work are important for the analysis of modern problems.

The Wealth of Nations represents a sustained attack on the mercantilist system. It gives much more space to an analysis of this system, its operation and likely results, than to the competitive system which, Smith argued, the alternatives being discredited, 'establishes itself of its own accord'.[2] The insights he thereby supplies into political and bureaucratic processes, and most importantly the mode of analysis he employs to investigate individual behaviour in various institutional contexts, are of continuing relevance in present-day conditions.

Man and his 'situation'

Two elements formed the core of Adam Smith's analysis both of the mercantilist system and his 'system of natural liberty': his view of what motivates and directs man and the institutional context in which individuals find themselves or, as Smith put it, 'the situation

[1] Adam Smith, *The Wealth of Nations*, ed. Edwin Cannan, 4th Edition, 1925, Vol. II, p. 140.

[2] *The Wealth of Nations*, Vol. II, p. 184.

in which they are placed'. It is perhaps the fuller and more subtle appreciation of the nature of man as well as the more detailed attention to the institutional setting which ultimately distinguishes the study of political economy from that of economics.

Smith's conception of man was far from the selfish brute of popular mythology. As a moral philosopher he certainly attempted to establish self-interest and a regard for private happiness as 'upon many occasions very laudable principles of action' since they gave rise to 'the habits of economy, industry, discretion, attention and application of thought'.[3] As a matter of common observation, he undoubtedly regarded self-interest and a desire for the 'numberless artificial and elegant contrivances for promoting ease or pleasure' as a powerful stimulus to enterprise.[4] But selfish passions were not the only ones to motivate mankind. Qualities of benevolence, charity and sympathy were to be found to some degree in every individual, even in 'the greatest ruffian, the most hardened violator of the laws of society'.[5] Further, even when an individual's action was self-interested it was certainly not necessarily narrowly materialistic. All the toil and bustle in the world ultimately derived simply from a desire to be observed 'with sympathy, complacency and approbation'.[6]

Thus, when Smith refers to private 'interests', as he does at frequent intervals throughout *The Wealth of Nations*, he is not referring necessarily merely to *financial* interests but to any matter which could be expected in the circumstances to affect the sense of well-being of the individual. Private interests might include not only those 'artificial and elegant contrivances', but the good opinion of others, a sense of security, prestige, or a quiet life.

It is the behaviour of such an individual, 'self-interest' being widely defined to embrace more than simple consumption of goods and services, which Smith studies under varying institutional contexts in *The Wealth of Nations*. What will be the effect on him of the apprenticeship system, the poor law, the joint stock company, or the method of university finance? How can public officials be expected to dispose of public money? How will the granting of a monopoly affect the behaviour of a business man? Why has Parliament seen

[3] *Theory of Moral Sentiments*, 3rd Edition, 1767, Part VI, p. 366.

[4] *Theory of Moral Sentiments*, Part IV, p. 270.

[5] *Theory of Moral Sentiments*, Part I, p. 2.

[6] *Theory of Moral Sentiments*, Part I, pp. 83-84.

fit to grant extensive privileges to trading companies and other pressure groups of producers? These are the sorts of questions Smith is asking throughout *The Wealth of Nations*, and simply to record them in a list is to reveal their close affinity with modern issues.

An apprentice, argues Smith, is hardly likely to be industrious when reward is unrelated to effort for such an extended period.[7] In these circumstances he will take what opportunities exist for increasing his well-being in other ways. A university lecturer, paid not by his students but by some endowment or charity, will neglect his teaching and employ his time 'in any way from which he can derive some advantage, rather than in the performance of his duty, from which he can derive none'.[8] Rules will be made for the ease of the staff and the subjects taught will be those which result in the greatest acclaim from colleagues rather than the greatest benefit to students.[9] A commercial enterprise organised on the joint-stock principle will end in bankruptcy since the directors are unlikely to watch with the same 'anxious vigilance' over other people's money as they watch over their own.[10]

Let the government of the towns fall into the hands of traders and they will take the opportunity to pass laws restricting entry into each trade.[11] Let officials have control over public money, that is, other people's money, and they rapidly become 'the greatest spendthrifts in society'.[12] Give an individual authority to build a road from public funds and he will build one to his country palace. Allow him to plan and execute bridges and he will aim to improve the view from the residence of some other official whose patronage he desires.[13] Let a 'great magistrate' choose between a number of projects and he will favour grandiose schemes which can be seen and admired by his supporters, over small projects 'which have nothing to recommend them but their extreme utility'.[14] Finance a local project such as street

---

[7] *The Wealth of Nations*, Vol. I, p. 124.

[8] *The Wealth of Nations*, Vol. II, p. 250.

[9] *The Wealth of Nations*, Vol. II, pp. 253-260.

[10] *The Wealth of Nations*, Vol. II, p. 233.

[11] *The Wealth of Nations*, Vol. I, p. 126.

[12] *The Wealth of Nations*, Vol. I, p. 328.

[13] *The Wealth of Nations*, Vol. II, p. 216.

[14] *The Wealth of Nations*, Vol. II, p. 220.

lighting out of local instead of national revenue and it will be better and more economically executed because those who spend are more closely constrained by those who pay, and abuses are more easily corrected.[15]

Forerunner of modern theory

Many other examples could indicate how pervasive is Adam Smith's interest in the influence of institutional and other constraints upon individual behaviour. People behave differently in different contexts not because they turn into different people, but because the opportunities and difficulties of achieving certain objectives conducive to personal welfare vary between different situations. The type of analysis which Smith presents, though somewhat crude, and in 18th-century language, is absolutely at one with many modern developments in economics, developments such as the study of property rights and their effect on decision-making, the economics of bureaucratic processes, and the analysis of collective choice.

If the behaviour of individuals depends upon their situation or 'the system of government', the obvious question arises: What situation or system of government ought to be adopted? Smith favoured the 'system of natural liberty', or the competitive system, for essentially four reasons. First, the granting of monopolies or other interference from the state distorted the market and induced stock to go from more to less productive employments (the equivalent of modern 'efficiency' considerations); second, competition was most conducive to 'accumulation' (an economic growth argument); thirdly, intervention by governments was 'oppressive' and an infringement of liberty; and, lastly, being a moral philosopher he was not indifferent to what he thought were the beneficial effects on individuals of competition—the stimulus to probity and fair dealing, application and initiative.

Smith did not expect the mere removal of state interference to produce Utopia. Some activities would tend to monopoly even in the absence of official encouragement (maintenance of the toll-roads, for example), and in these circumstances commissioners or trustees might be appointed supervised by 'proper courts of inspection and account'.[16] Similarly, he recognised that certain desirable public

[15] *The Wealth of Nations*, Vol. II, p. 222.

[16] *The Wealth of Nations*, Vol. II, p. 217.

works or institutions would require public finance if the profit were insufficient to induce private individuals to undertake them[17] or, as we should now express it, if private net benefit fell short of social net benefit. Nevertheless, these exceptions must have appeared of less significance to him than they do to us, and the general presumption in favour of a competitive system unhindered by government regulation was established for more than a century thereafter.

'Market failure'

Two somewhat contradictory trends characterised developments in the last half of the 19th and the first half of the 20th centuries. As technological change and population growth began to pose awkward problems for the competitive system, the system itself was being re-interpreted and refined by economists until it would have been unrecognisable to Adam Smith. Elegant proofs of the allocative 'efficiency' of the system under highly stylised and indeed almost totally imaginary conditions were produced, and when it was observed that markets in practice almost everywhere departed in some degree from these norms, the conclusion was drawn that 'market failure' had occurred and that some form of 'market correction' was required. For in the absence of 'efficiency', what other justification was there for a competitive order? The idea that competition was a spur to good management received very little attention and had to be re-invented as 'X-efficiency' in the early 1960s. That it might have morally desirable effects on individuals and lead to international friendship were considerations quite out of the new 'ethically neutral' arena of discussion; the general presumption was, in any event, quite the contrary. That the system might be conducive to personal liberty was likewise suspect, as a matter appropriate for the consideration of economists, and was in addition buried beneath the mound of confusion which has become associated with the very meaning of the term.

So accustomed had economists become by this stage to regarding individuals as disembodied 'utility functions' containing as 'arguments' quantities of goods and services, that solutions to the problems raised by market failure were devised within the same frame-

[17] *The Wealth of Nations*, Vol. II, p. 185.

work. Conditions for the 'efficient' output of public goods[18] were derived impeccably from the preferences of individuals and the opportunity costs of production; if externalities in production or consumption were a problem, the economist could produce 'optimal' solutions along with appropriate tax or subsidy arrangements for achieving them; the ideal pricing policy for public utilities could be deduced at the drop of a Langrangean multiplier,[19] and if 'second-best' considerations[20] were introduced a few more of the same would no doubt produce the required result.

Government failure: public choice

These efforts were undoubtedly helpful to logical thought, but in implicitly assuming the existence of an all-knowing, all-powerful state able costlessly to implement optimal policies, they ignored what would have been obvious to Adam Smith—'government failure'. Decisions about the consumption of public goods, if they are to be based on individual preferences, require that people reveal these preferences in some form of political process. Further, once a collective choice has been made it must be implemented by public officials whose behaviour will be crucial in determining outcomes. The chances that public policy, formulated *via* the clash of political parties and implemented by departments of state or public corporations, will turn out to be 'efficient' in the sense used by economists must appear somewhat remote. Reasoning of this type has stimulated interest in the analysis of collective choice under various decision rules, and in the behaviour of individuals in their capacities as voters, politicians or bureaucrats. By thus taking up once more the study of political economy, we are at last beginning to catch up with Adam Smith.

---

[18]Public goods are 'non-rival' in consumption: the consumption of one individual does not reduce the quantity available for the consumption of others. The classic example is defence.

[19]A mathematical technique much favoured by economists when attempting to maximise a 'function' subject to a 'constraint'.

[20]The pricing rule derived from welfare economics that price should be set equal to marginal costs of production applies only if it can be assumed that all other prices in the economy are equal to marginal costs. Where monopoly or some other distortions exist elsewhere, or where the public enterprise is constrained by financial targets, pricing policy can attain only a 'second-best' solution.

If markets can 'fail' (in the technical sense of producing 'inefficient' outcomes), and if governments cannot be relied upon to succeed in their place, the question of where and in what degree the state should intervene in the economic life of the country is highlighted in all its baffling complexity. Modern debates concerning industrial strategy, the nationalised industries, the social services, the behaviour of the unions, the growth of public expenditure, the control of pollution, are all fundamentally about the response of individual decision-makers to varying institutional constraints, and hence about the type of institutional arrangements which might be expected to produce optimal results. Adam Smith did not examine these problems or present a fully developed theory of political or bureaucratic processes, but his observations on the mercantilist system stem from an approach easily adapted to the more modern context.

The recent subventions to firms in financial difficulty, for example, bear a close resemblance to the granting of statutory monopolies, tariff protection or export bounties in the 18th century. On these policies Smith's comments are of enduring relevance.

First, Smith pointed to the enormous amount of information required by governments interfering in industry. In these activities, he maintained, 'the sovereign . . . must always be exposed to innumerable delusions'.[21] Worse still, it will always be in someone's interests to foster such delusions.[22]

Second, where financial returns may be affected by political decisions an incentive will exist to invest in political pressure rather than in market or product development. Further, the amount of this investment will be positively related to the likely political 'returns'. How is it, asks Smith, that leather manufacturers can export their commodities duty free whilst the graziers cannot export their cattle at all? It is because the latter are widely dispersed and cannot so easily form a pressure group as the manufacturers who live in the cities.[23] In addition, large manufacturers can, when it suits them, 'occasion a mutiny and disorder alarming to government, and embarrassing even to the deliberations of the legislature'.[24]

Third, the personal reactions of individual Ministers in various

[21] *The Wealth of Nations,* Vol. II, p. 184.

[22] *The Wealth of Nations,* Vol. I, p. 250; Vol. II, p. 150.

[23] *The Wealth of Nations,* Vol. II, pp. 154-155.

[24] *The Wealth of Nations,* Vol. I, p. 436.

situations will be important. A Minister or member of parliament opposing a powerful pressure group may endanger his political career as well as run the risk of suffering 'the most infamous abuse and detraction'.[25]

Such considerations are as important today as they were in 1776. On their own they make it unlikely that a government's 'industrial strategy' will bear much resemblance to the precepts of theoretical welfare economics. At worst they suggest that it will be the outcome of ignorance and plain political expediency.

Nationalised industries: welfare services

Control of the nationalised industries raises similar problems of devising a system of constraints within which they can be expected to achieve specified objectives. Smith could not have failed to note that a public monopoly is no less a monopoly than a private one, and that disciplines upon behaviour are further relaxed by the absence of a public-sector equivalent of bankruptcy. The changed institutional structure immediately influences the prospects of gain any action may be expected to bring the parties. Politicians who, at any time, may be questioned in Parliament and elsewhere about investment, pricing or output policy, will feel impelled by their circumstances to intervene in day-to-day operations, chairmen may find it convenient to remain on good terms with Ministers, unions will not fail to notice the much improved situation for obtaining monopoly rents,[26] and the discipline which in a competitive situation consumers may exert by withdrawing their custom is considerably reduced. Policy objectives, formulated through the clash of interest-groups, are unlikely to remain stable for long as political imperatives change and alter the bargaining situation. Nor, as has often been noted, will it usually be in the interests of politicians in a party democracy to explain underlying objectives.

The importance of this type of analysis in the modern context is increasingly evident. Dissatisfaction with the social services, for

[25] *The Wealth of Nations*, Vol. I, p. 436.

[26] A strong monopoly seller of labour (the union) facing an employer with monopoly power in the product market may use its bargaining power to obtain for its members wage rises which would otherwise appear as monopoly profits for the employer. Factor payments in excess of those required to retain the services of the factor are termed 'rents'.

example, has led researchers to wonder whether the behaviour of individuals in their capacities as voters, taxpayers and hence suppliers of education, medical care and so on, is compatible with their predicted behaviour as demanders, given present institutional arrangements. The seemingly inexorable growth in public expenditure has prompted the suggestion that there may be a long-run bias in favour of expansion in the size of the budget deriving from the individual interests of politicians and bureaucrats. The behaviour of the unions during the last 30 years can be seen as a response to changed limitations, such as the commitment by all governments to full exployment and the payment of welfare benefits to the families of strikers.

Suggestions for reform tend, in consequence, to revolve around institutional changes thought to be conducive to more efficiency. Hence the support for postal ballots in union elections which reduce the costs to individuals of voting and which might, in consequence, induce the less 'committed' (those who anticipate fewer personal benefits from political activity) to overcome the inevitable tendency to rational abstention. Hence the idea that simultaneous instead of separate consideration of the tax and expenditure sides of the budget might curb the spending enthusiasm of individual politicians by exposing them more openly, not merely to the approbation of the beneficiaries, but also to the possible hostility of the taxpayers. Hence the recent suggestion that if, as Smith himself remarked, politicians will always be principally concerned 'to relieve the present exigency',[27] control over the money supply might be better exercised by an independent agency (that is, one less corsetted by short-term political pressure).

18th-century warning against 20th-century mercantilism

Enumeration of these issues does not in itself demonstrate anything about the best political and administrative setting for conducting public-sector activities. It does, however, illustrate the importance of subjecting political and bureaucratic processes to the same kind of rigorous scrutiny hitherto reserved for markets. *The Wealth of Nations* contained just such a scrutiny of the then mercantilist system, and it was awareness of the inevitable limitations of government action as much as confidence in market processes which inclined Smith to support the 'system of natural liberty'. It is not, therefore,

[27] *The Wealth of Nations*, Vol. II, p. 401.

Adam Smith's analysis of the competitive system he recommends, but his analysis of the mercantilist system he rejects, which is of relevance to us in 1978. It underlies many recent suggestions for administrative change, for example in the finance of education, and yields a host of questions concerning the appropriate government response, if any, to manifestations of market failure.

List of Participants at IEA Seminar *(25 April, 1978)*

(Platform contributors are indicated in the Table of Contents, pp. v-x.)

ALT, JAMES, *Lecturer in Government, Essex University*
ANDRESKI, S. L., *Professor of Sociology, Reading University*

BATEMAN, SIR RALPH, *Vice-President, Confederation of British Industry*
BATTEN, P. J., *Staff Tutor, Economics, Open University*
BEALE, NEVILLE, *Consultant*
BEAVIS, BRIAN, *Lecturer in Economics, Newcastle University*
BLAUG, MARK, *Professor of the Economics of Education, University of London*
BOON, GRAHAM, *Lecturer in Economics, Newcastle University*
BOWRING, EDGAR, *Chairman, C. T. Bowring*
BREMNER, MOYRA, *'Money Programme', BBC; Sunday Times*
BROWN, C. V., *Professor of Economics, Stirling University*
BRUCE-GARDYNE, JOCK, *Member of Parliament, 1964-74*
BULLOCK, ANNE, *Head of Economics Department, Conservative Research Department*
BURN, DUNCAN, *Formerly leader writer and Industrial Correspondent, The Times*
BURNETT, D., *Lecturer in Economics, Newcastle Polytechnic*
BURTON, JOHN, *Principal Lecturer in Economics, Kingston Polytechnic*
BYATT, IAN C., *Deputy Chief Economic Advisor to HM Treasury*

CAIRNCROSS, FRANCES, *Economics Correspondent, The Guardian*
CAVE, MERRIE, *Lecturer, International Studies, Hammersmith & West London College*
CULLIS, JOHN, *Lecturer in Humanities and Social Science, Bath University*
CULYER, ANTHONY, *Senior Lecturer in Economics and Related Studies, York University*
DARNELL, ADRIAN, *Lecturer in Economics, Durham University*
DAVEY, DR NEIL, *Treasury Representative, Australian High Commission*
DAVISON, G., *Lecturer, Economics & Politics, Kingston Polytechnic*
DICKSON, PAUL, *Undergraduate, Oxford*

EDEN, DOUGLAS, *Lecturer in Politics, Middlesex Polytechnic*
ELKAN, WALTER, *Professor of Economics and Head of Department, Brunel University*
ELSE, A. K., *Senior Lecturer in Economics, Sheffield University*
ELST, PHILIP VANDER, *Freelance Writer and Lecturer*
ELTIS, WALTER, *Lecturer in Economics, Exeter College, Oxford*
EYRES, STEPHEN, *Political Researcher*

FISHER, ANTONY, *Chairman, IEA Trustees*
FISHER, MRS ANTONY
FOX, ROGER, *Lecturer in Economics, Thames Polytechnic*

GOODRICH, CHRIS., *Ph.D. Student, LSE*
GRANT, ROBERT M., *Lecturer in Business Economics, City University*
GILLIE, A., *Lecturer in Economics, Open University*
GILLMAN, DR JOHN, *Publisher, W. H. Freeman & Co. Ltd.*

HALE, ROLAND, *Head of Economics, Emmanuel School, Wandsworth*
HARTLEY, DR KEITH, *Senior Lecturer, Economics & Related Studies, York University*
HAWKINS, DR MICHAEL, *Lecturer in Politics, Kingston Polytechnic*
HENNESSEY, PETER, *Home News Correspondent, The Times*
HENRY, W. R., *Chairman, Coats Patons*
HOUGHTON, R., *Senior Lecturer in Economic Studies, Sheffield University*
HOWARTH, R. W., *Lecturer in Agricultural Economics, University of North Wales*
HUGHES, DR G., *Senior Lecturer in Economics, Kingston Polytechnic*
HUMPHREY, PATRICK, *Liberal Party, Transport Panel*

JACKSON, DR P. M., *Director of the Department of Public Sector & Economics, Leicester University*
JOHNSON, NEVIL, *Professorial Fellow Librarian, Nuffield Reader in Comparative Studies of Institutions, Oxford*
JONES, B. L., *Corporate Planning Manager, IBM*
JONES, GEORGE, *Professor of Government, LSE*
JUDGE, KEN, *Lecturer in Social Administration, Bristol University*

LAMB, RICHARD, *City Editor, Time and Tide*
LEPAGE, HENRI, *Institut de l'Enterprise, Paris*
LITTLECHILD, STEPHEN, *Professor and Head of Economics, Industrial and Business Studies, University of Birmingham*
LOASBY, BRIAN, *Professor of Economics, Stirling University*
LYNN, RICHARD, *Professor of Psychology, Ulster University*

MCALLISTER, RICHARD, *Lecturer in Politics, Edinburgh University*
MCCORMICK, B., *Reader in Economics, Sheffield University*
MACMILLAN, JAMES, *Political Advisor, Daily Express*
MARGOLIS, CECIL, *North Yorkshire County and Harrogate Councils*
MARSHALL, G. P., *Lecturer in Economics, University of Sheffield*
MAYNARD, ALAN, *Lecturer in Economics, York University*
MEADE, J. E., *Professor, Fellow of Christ's College, Cambridge*
MEAKIN, J. C. H., *Director for Smaller Firms, CBI*
MOUNT, FERDINAND, *Feature Writer, Spectator*
MYDDELTON, DAVID, *Professor of Finance & Accounting, Cranfield School of Management, Cranfield Institute of Technology*

OKANO, YUKIHIDE, *Professor of Economics, Tokyo University*
O'MAHONEY, DAVID, *Professor of Economics, Cork University*
O'SULLIVAN, JOHN, *Leader Writer, Daily Telegraph*

PAPPS, IVY, *Lecturer in Economics, Durham University*
PEPPER, GORDON, *Partner, W. Greenwell and Company*
PERLMAN, DR MORRIS, *Senior Lecturer in Economics, LSE*
PREST, ALAN, *Professor of Economics, LSE*
PRIDEAUX, SIR HUMPHREY, *Chairman, Brooke Bond Liebig*
PRINGLE, ROBIN, *Editor, The Banker*

REEKIE, DR DUNCAN, *Lecturer in Business Studies, Edinburgh University*
REES, JOHN, *Headmaster, Elmgrove School, Harrow*
RICHARDS, GORDON, *Lecturer in Government, Hammersmith & West London College*
RICKETTS, MARTIN, *Lecturer in Economics, University College at Buckingham*
ROBINSON, DR ANN, *Lecturer in Politics, Cardiff University*
RUSSELL, PAULINE, *Student*

SANDFORD, C. T., *Professor of Political Economy, Bath University*
SAVIN, C. T., *Policy Review Unit, British Petroleum*
SCHWARTZ, GEORGE, *Member of Advisory Council, IEA*
SEAL, W., *Lecturer in Economics, Trent Polytechnic*
SELDON, ANTHONY, *Ph.D. Student, LSE*
SELDON, MARJORIE, *Chairman, Friends of the Education Voucher Experiment in Representative Regions (FEVER)*
SENIOR, IAN, *Senior Consultant, Economists Advisory Group*
SEWILL, BRENDON, *Committee of London Clearing Banks*
SHAPIRO, DR D. M., *Reader in Government, Brunel University*
SHENFIELD, ARTHUR, *Barrister, Visiting Professor, US Universities*
SHERMAN, ALFRED, *Kensington Council*
STUTCHBURY, OLIVER, *Author of 'Too Much Government'*
SUGDEN, ROBERT, *Lecturer in Economics, York University*
SUTCLIFFE, CHARLES, *Lecturer in Economics, Reading University*
SUTHERLAND, B. W., *Director, Harris and Sheldon Group*

TAME, CHRIS., *Journalist*
THOMPSON, NORMAN, *Senior Lecturer in Economics, Adelaide University, Australia*
THOMPSON, DR G. F., *Lecturer in Economics, Open University*
TINGLE, RACHAEL, *Freelance Researcher and Writer*
TOYE, J., *Fellow, Wolfson College, Cambridge*

WAKEHURST, LORD, *Chairman, Continental Illinois Limited*
WASSELL, MARTIN, *International Chamber of Commerce, Paris*
WEALE, DR ALBERT, *Lecturer in Politics, York University*
WHISKER, MISS PATRICIA, *Ph.D. Student, Bath University*
WHITELEY, PAUL, *Lecturer in Economics and Politics, Kingston Polytechnic*
WILSON, TOM, *Professor of Political Economy, Glasgow University*

YOUNG, DR ALISTAIR, *Senior Lecturer in Economics, Paisley College of Technology*

Author Index

Subject Index

SOME IEA PAPERS ON
ASPECTS OF THE NEW ECONOMICS OF POLITICS

Hobart Paper 78
The Consequences of Mr Keynes
JAMES M. BUCHANAN, JOHN BURTON and R. E. WAGNER
1978 £1·50
'In order to provide against irresponsible budget deficit financing, the authors of the booklet call for a written rule for the British Parliament that there should be no budget deficit.' Leader in *Yorkshire Post*

Occasional Paper 51
Inflation and Unemployment: The New Dimension of Politics
MILTON FRIEDMAN
1977 2nd Impression 1978 £1·00
'I have to warn you that there is neither shock nor horror nor sensation in his lecture, only close reasoning, and a sense of scholarly inquiry . . . I urge readers to buy and read [it].' Patrick Hutber, *Sunday Telegraph*

Hobart Paperback 9
The Vote Motive
GORDON TULLOCK
with a Commentary by Morris Perlman
1976 £1·50
'Professor Tullock's tract deserves our attention because it is disturbing, as it is meant to be. It invites us to consider further what we should be constantly considering—those comfortable assumptions about our institutions that prompt us to shy away from changes that might be beneficial. There is more in common between the public and private sectors than most of us are willing to allow.' *Municipal Journal*

Hobart Paperback 5
Bureaucracy: Servant or Master?
WILLIAM A. NISKANEN
with Commentaries by
Douglas Houghton, Maurice Kogan, Nicholas Ridley and Ian Senior
1973 £1·00
'Niskanen argues, with some cogency, that every kind of pressure on a bureau head leads him to maximise his budget.'
Peter Wilsher, *Sunday Times*

Hobart Paperback 1
Politically Impossible . . .?
W. H. HUTT
1971 75p
'The analysis that Hutt offers is a refreshing and succinct attempt to identify the economic consequences of present trends in welfare expenditure, and the political temptations and attractions he thinks are offered by the alternative policies available. He lives up to the strict standards he suggests for his fellow economists in the earlier section of the book.'
John Biffen, *Spectator*

IEA Readings in Print

1. Education—A Framework for Choice
A. C. F. Beales, Mark Blaug, E. G. West, Sir Douglas Veale, *with an Appraisal by* Dr Rhodes Boyson 2nd Edition 1970 (xvi+100pp., 90p)

2. Growth through Industry
John Jewkes, Jack Wiseman, Ralph Harris, John Brunner, Richard Lynn, and seven company chairmen 1967 (xiii+157pp., £1·00)

4. Taxation—A Radical Approach
Vito Tanzi, J. B. Bracewell-Milnes, D. R. Myddelton 1970 (xii+130pp., 90p)

5. Economic Issues in Immigration
Charles Wilson, W. H. Hutt, Sudha Shenoy, David Collard, E. J. Mishan, Graham Hallett, *with an Introduction by* Sir Arnold Plant 1970 (xviii+155pp., £1·25)

7. Verdict on Rent Control
F. A. Hayek, Milton Friedman and George Stigler, Bertrand de Jouvenel, F. W. Paish, Sven Rydenfelt, *with an Introduction by* F. G. Pennance 1972 (xvi+80pp., £1·00)

9. The Long Debate on Poverty
R. M. Hartwell, G. E. Mingay, Rhodes Boyson, Norman McCord, C. G. Hanson, A. W. Coats, W. H. Chaloner and W. O. Henderson, J. M. Jefferson
2nd Edition with an introductory essay by Norman Gash 1974 (xxxii+243pp., £2·50)

10. Mergers, Take-overs, and the Structure of Industry
G. C. Allen, M. E. Beesley, Harold Edey, Brian Hindley, Sir Anthony Burney, Peter Cannon, Ian Fraser, Lord Shawcross, Sir Geoffrey Howe, Lord Robbins
1973 (ix+92pp., £1·00)

11. Regional Policy For Ever?
Graham Hallett, Peter Randall, E. G. West 1973 (xii+152pp., £1·80)

12. The Economics of Charity
Armen A. Alchian and William R. Allen, Michael H. Cooper, Anthony J. Culyer, Marilyn J. Ireland, Thomas R. Ireland, David B. Johnson, James Koch, A. J. Salsbury, Gordon Tullock 1974 (xviii+197pp., £2·00)

14. Inflation: Causes, Consequences, Cures
Lord Robbins, Samuel Brittan, A. W. Coats, Milton Friedman, Peter Jay, David Laidler *with an Addendum by* F. A. Hayek 1974 3rd Impression 1976 (viii+120pp., £2·00)

15. The Dilemmas of Government Expenditure
Robert Bacon and Walter Eltis, Tom Wilson, Jack Wiseman, David Howell, David Marquand, John Pardoe, Richard Lynn 1976 (xi+110pp., £2·00)

16. The State of Taxation
A. R. Prest, Colin Clark, Walter Elkan, Charles K. Rowley, Barry Bracewell-Milnes, Ivor F. Pearce
Commentaries by Geoffrey E. Wood, Alun G. Davies, Nigel Lawson, T. W. Hutchison, Alan T. Peacock, Michael Moohr, Malcolm R. Fisher, George Psacharopoulos, Dennis Lees, J. S. Flemming, Douglas Eden *with an Address by* Lord Houghton
1977 (xvi+116pp., £2·00)

17. Trade Unions: Public Goods or Public 'Bads'?
Lord Robbins, Charles G. Hanson, John Burton, Cyril Grunfeld, Brian Griffiths, Alan Peacock
Commentaries by Peter Mathias, Norman McCord, P. J. Sloane, J. T. Addison, Martin Ricketts, George Yarrow, Charles T. Rowley, Dennis Lees, Harry Ferns, Keith Hartley, Reg Prentice, Jo Grimond *with an Address by* Lord Scarman
1978 (xiv+134pp., £2·00)