

Government by the Market?

The Politics
of Public
Choice

Peter Self

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**Westview Press
Boulder & San Francisco**

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Published 1993 in Great Britain by
THE MACMILLAN PRESS LTD
Houndmills, Basingstoke, Hampshire RG21 2XS
and London

Published in 1993 in the United States by
WESTVIEW PRESS
5500 Central Avenue
Boulder, Colorado 80301

Library of Congress Cataloging-in-Publication Data
Self, Peter.

Government by the market? : the politics of public choice / Peter Self.

p. cm.

Includes bibliographical references and index.

ISBN 0-8133-1982-X (hc : alk. paper). — ISBN 0-8133-1983-8 (pbk. : alk. paper)

1. Social choice. 2. Economic policy. 3. Capitalism. 4. Policy sciences. I. Title.

HB846.8.S46 1993

302'.13—dc20

93-20677
CIP

Printed in Hong Kong

10 9 8 7 6 5 4 3 2 1

This book is printed on acid-free paper.

Preface

In recent decades a powerful new paradigm of the proper scope and limits of government action has become dominant in Western democracies. This paradigm holds that governments should in general do less; that they should reduce or relinquish their previous responsibilities for maintaining full employment and a comprehensive system of state welfare; that they should privatise public services or their delivery wherever practicable; and that they should reform their own operations in accordance with market concepts of competition and efficiency. These beliefs in 'government by the market' rest upon propositions that the market system is inherently a better method for satisfying human wants and aspirations than recourse to government, and that the political process is subject to numerous imperfections and distortions. The aims of this book are to investigate the intellectual foundations of this new ideology, to examine the numerous public policies that have been (and are being) followed within its general rubric, and to evaluate these beliefs in terms of broader social values and understandings of 'the public interest'.

The intellectual basis for these new doctrines come from market theory and public choice thought. This book concentrates primarily upon the public choice element, because while market theory celebrates or defends the virtues of competitive markets (a subject taken up in Chapter 7), public choice concentrates upon the problems and limitations of the democratic political process. Thus it is able to provide a critically important collaboration to the advocacy of market theory by dealing specifically with issues of politics and political failure. Because public choice is in principle no more than an economic tool of analysis, its political uses have not been clearly recognised; and because of its economic language, public choice is a somewhat esoteric and unfamiliar subject for students of politics and the general public, at any rate outside the USA. However, public choice in simplified or popularised forms has contributed a lot to political debates

and policies. In particular it has helped to erode the optimistic post-1945 belief in government planning and the welfare state, and to substitute the conclusion that the less governments do, the better.

Public choice theory represents the application of economic methodology to the study of politics. In principle it is an objective study not wedded to any particular political belief, but its inquiries are shaped by its strongly individualist and rationalist assumptions. These assumptions lead to a critical view of the political process owing to the many opportunities which it is said to provide for self-seeking behaviour, and an adverse view of the capacity of governments to satisfy individual wants compared with economic markets. Social choice (a related discipline) further brings in the intrinsic difficulties of making collective decisions upon a democratic basis.

The first three chapters offer a concise survey of public choice theories. My concerns have naturally been different from those of economic theorists. Public choice writers use an economic language which they do not usually relate to more conventional or traditional treatments of politics (an exception is James Buchanan, who does specifically relate his public choice theories to the history of political thought). In attempting to bridge this gap, I cannot do justice to the many sophisticated economic treatments of politics which occur in the literature, my concern being to present a readable analysis to a non-economist (although my interpretations and conclusions are also addressed to economists). The treatment has also to be selective in line with the wider purpose of the book of discussing the influence of ideas upon policies.

Thus I first take a critical look at the assumptions of public choice because they influence all that follows about the nature of politics. In Chapter 2 I try to pull together and evaluate some public choice theories about the behaviour of principal actors in the political process. Chapter 3 shows how certain strong conclusions by public choice writers have been utilised to build up the ideology of 'government by the market'. I want to stress here that a methodology based upon the idea of rational self-interest need not support these conclusions and can be turned instead into a strong critique of the market system. I recognise these alternative theories in the text, without having space to review them adequately, but I suggest that the highly individualist assumptions of public choice do point in a clear ideological

direction. The public choice assumptions after all are those conventionally used to justify the market system in classical economics. Thus the main thrust of public choice writing, and still more of its political influence, have been to discredit democratic government and to extol the market system.

The next three longer chapters analyse the public policies pursued by political leaders in efforts to reduce the scope, range and costs of government and drastically to change methods of public administration and service delivery. These chapters are organised around the three themes of slimming the state, privatising welfare and restructuring government as key elements in a wide-ranging programme of political change. The examples are taken from English-speaking democracies where these political goals have been most evident, especially from Britain and the USA but also in some contexts from Australia, New Zealand and Canada. The Reagan and Thatcher years provide a laboratory for testing these policy innovations and the treatment is sometimes explicitly comparative. However, the general aim is not a comparative survey but an illustrative discussion of policies in a variety of arenas in order to demonstrate some of the goals and effects of this major shift in the relations between government and society.

This account of recent political history should have an intrinsic interest, whatever theoretical conclusions are or are not drawn. The influence of public choice thought (albeit in a popularised form) can be seen both in the general assumptions on which political leaders based their policies and also sometimes in the strategies which they pursued to disarm or overcome opposition. There is, however, a certain irony in the use or relevance of public choice thought in a policy context. The same critique of self-seeking political behaviour which supports the ideology of 'slimming the state' also suggests that the effort will be unsuccessful because of the necessary mobilisation of new interests (such as those embedded in the market system) and the costs of buying out existing interests. By the end of the 1990s it can be seen that the outcome of all these activities has been not so much to slim government itself as to alter quite drastically its economic and social responsibilities as well as its distribution of favours and sacrifices among the members of society.

The last three chapters revert to a more theoretical framework which revolves around the respective capacities of the market and political systems to satisfy individual wants and aspirations.

Chapter 7 investigates the performance of the market system against the claims of both public choice and market theory, and goes on to discuss the powerful impact of market ideology upon public policies, using a number of illustrations. Chapter 8 shows the failures of public choice and market theories to offer any tenable concept of the 'public interest' or to satisfy basic criteria of individual rights and social justice. The defects of the political system, including its tendencies to extremism and alienation and its liability to strong ethnic or group conflicts, are also sketched. Answers to these problems are sought in the concept of responsible and active citizenship and in Chapter 9 are further pursued through the search for a new policy paradigm that could enable democratic governments to realise social values which markets cannot satisfy.

Two points should be clarified about the purposes of this book. It nowhere suggests or supposes that public policies are likely to be closely based upon academic theories or prescriptions. Politics is a highly pragmatic activity which does not consistently follow any general principles of policy. Nonetheless it is the author's belief, which has grown stronger as the book has progressed, that ideas and ideology do count a great deal in politics, even though their application is much distorted by political considerations. They provide the essential basis of assumed social realities whereby political leaders explain and justify their policies to the public, backed by a media which keeps the range of 'realistic' options within narrow limits. It is usual here to refer to Keynes' aphorism that every practical man is the slave of some defunct economist. In respect of current policies the economists in question are alive, kicking and influential, but otherwise there is truth in Keynes's statement.

Secondly, in criticising the 'self-interest' assumption of public choice, I do not mean to revert to an idealistic tradition about the state which assumes extensive public-spirited behaviour. While self-interest and altruism both exist, the former is generally the more dominant motive; but the directions and degrees of self-interest depend very much upon the structure of opportunities within a given political and economic system, and upon the ethical norms (or their absence) which regulate behaviour in that system. In *The Culture of Contentment* (1992) J. K. Galbraith reaches the gloomy conclusion that highly irrational and short-sighted public policies will continue to be pursued because they suit the perceived self-interest of the affluent majority of the population

(by which he means a majority of those voting and holding effective power, not a majority of the whole population). This view that the 'affluent' are myopic even about their own longer-term interest does not wholly square with the assumption of *rational egoism*, and seems to me to be too gloomy a view of the propensities and future of the human species. What seems truer is that a shift to more aggressive and short-sighted forms of self-interest is being brought about by the retreat of democratic governments from responsible economic and social policies.

This situation raises a political issue which is now crucial (although often not recognised as such) for the life and future of democratic societies. How far must or should significant social goals be sacrificed in order to comply with the criteria of economic efficiency imposed by the workings of the international market system? Government policies have increasingly been guided by this assumed requirement, even at the cost of rising unpopularity. Political conflict and extremism have grown because of it. I am not of course reducing political events to a single cause, but suggesting that the drift from a more democratic and pluralist model of government to a less open and more authoritarian one can be partly at least explained in these terms. One lesson from this book is that governments, whether acting individually or collectively, need to recover more room for manoeuvre in the service of social goals.

I am grateful for comments on parts of the book from individual scholars. My thanks are especially due to Hugh Stretton, who read the whole draft and on particular chapters to Rudolf Klein, Harvey Feigenbaum, Phyllis Colvin, Jonathan Boston, Patrick Dunleavy, John Nethercote, Carol Weiss, Maurice Kelly, Bob Goodin, Jan Lamboy, Campbell Sharman and Peter Williams. I am also grateful for some constructive suggestions on public choice issues from my publisher's reviewers, Keith Dowding and Ian Holliday. None of these individuals have any responsibility for the use made of their advice. I have also benefited from seminar discussions on parts of the book at the Australian National University and several other Universities.

The Research School of Social Sciences in the Australian National University provided me with a supportive and friendly base for research and writing over two years as a Visiting Fellow in the urban research and politics programmes. My special thanks go to Penny Hanley in urban research for help with the bibliography and to Christine Treadwell in politics who word-

processed successive drafts with accuracy, speed and patience. My publisher, Steven Kennedy, actively helped with advice and encouragement over the design of the book. My wife Sandra did her best to keep me to a timetable and tolerated my absorption in the book with much kindness.

Canberra

Peter Self

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1

Economic Interpretations of Politics

In the last thirty-five years a powerful new body of political thinkers has emerged, collectively known as the 'public choice' school. These thinkers model the study of politics upon the methods and assumptions of neo-classical market economics. Their writings have not only introduced a new intellectual view of the nature of politics but have had a considerable influence upon the conduct of politics and public policy, as this book will demonstrate.

The origins of the public choice school lie in the study of public finance and public goods by such writers as Wicksell and Lindhal. For some time the interest of economists was focused upon the question of what governments should do to remedy various forms of market failure, and upon the provision and financing of those 'pure public goods' which only governments can supply. Subsequently this concern was widened and reversed as economists started to compare the methods and problems of collective decision-making with those of competitive markets providing private goods. The rapid growth of governments after World War Two was an obvious stimulus to this field of study and contributed towards a radically different and more critical approach to the workings of government than traditional political science provided.

Public choice developed primarily in the USA and is still heavily concentrated there, although its influence has spread, especially to other English-speaking countries. It has produced a prolific volume of work which reflects the somewhat different approaches of the Virginia School led by James Buchanan and Gordon Tullock, who founded the Public Choice Society in 1963, and the Chicago School, represented by such writers as Mancur Olson and George Stigler. Earlier, in 1957, Anthony Downs had written his path-breaking *Economic Theory of Democracy*. The founding fathers, such as Buchanan, Tullock, Olson, William Riker and Anthony Downs, wrote some original works which

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advanced bold theories in fairly non-technical language. Later American writers have concentrated more upon testing hypotheses about specific issues of American politics. More broadly, and especially outside America, the economic approach has influenced the growth of 'rational actor' models of politics, which share a similar economic methodology but reach different conclusions.

This chapter provides a brief introduction to the basic assumptions of public choice thought and considers some of the critical issues which they raise. Its aim is to lay the ground for the review in Chapter 2 of the positive theories of public choice, and in Chapter 3 of its normative theories, which taken together have produced a body of beliefs or ideology with a potent influence upon political life.

Comparing economic and political systems

A well-known text-book gives the following definition of public choice:

Public choice can be defined as the economic study of non-market decision-making, or simply the application of economics to political science. The subject matter of public choice is the same as that of political science: the theory of the state, voting rules, voting behaviour, party politics, the bureaucracy and so on. The methodology of public choice is that of economics, however. The basic behavioural postulate of public choice, as for economics, is that man is an egoistic, rational utility maximiser.

(Mueller, *Public Choice*, Cambridge University Press, 1989, pp. 1–2)

Mueller notes that traditionally 'political man' (or woman) is supposed to be concerned with the public interest and 'economic man' with his private interest, but public choice rejects this dichotomy. Buchanan and Tullock (1962, pp. 20–3) ask why we should assume that an individual 'changes gear' when he moves from the private to the public sphere. He is still the same person, and it is reasonable to assume that his basic motives and interests will remain the same. What will change are the constraints and rules under which he operates, which will be critical for the rational calculation and pursuit of his private interest.

This leads to the other element in Mueller's definition – the special conditions of collective action or 'non-market decision-making'. What is the relationship between the economic and

political systems? Many writers, such as Schumpeter (1943), have stressed the close cultural and institutional linkages between market capitalism and parliamentary democracy. Marxist theorists have made precisely the same point from the opposite viewpoint of arguing the dependence of liberal democracy upon capitalist interests (MacPherson, 1962). Before Marx the great classical economists such as Smith, Ricardo and Malthus stressed the significance for political behaviour of the conflicts of interest between different economic classes.

However the economic model used by mainstream public choice is the neo-classical one of perfectly competitive markets. Markets are assumed to work through voluntary exchanges between free individuals, each pursuing his or her private self-interest. Markets move towards an equilibrium point where no individual would profit from buying or selling a different product, or from changing his or her occupation. However this equilibrium point is continually moving with changes in individual tastes, costs of production, or the arrival of new products. If, in the homely example, individuals start demanding more coffee and less tea, the production of these commodities will shift until the marginal revenue that can be earned from either product equals the marginal cost of its production. By such continual marginal adjustments markets are said to respond spontaneously to consumer demands, thereby achieving 'allocative efficiency'.

Actual market systems do not satisfy the strong requirements of this ideal model, for example over perfect competition, full information or in other respects. However public choice theorists can still utilise this model to map certain features of political life. Following this approach, voters can be likened to consumers; political parties become entrepreneurs who offer competing packages of services and taxes in exchange for votes; political propaganda equates with commercial advertising; government agencies are public firms dependent upon receiving or drumming up adequate political support to cover their costs; and interest groups are co-operative associations of consumers or producers of public goods. Moreover the whole political system can be viewed as a gigantic market for the demand and supply of 'public goods', meaning all outputs supplied through a political instead of a market process (and including regulations and transfer payments as well as goods and services).

The 'political market' is cruder and harder to study than the market system. Market transactions can be measured and

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analysed in the common unit of money. Political transactions involve voting, which can be counted like money but which covers only a part of politics. Political action involves the exercise of authority, power and influence. Laws and government decisions can be known but influence is often elusive or secretly exercised. Nonetheless power or influence is in some ways the analogue of money, because it is the means through which political actors pursue their goals.

Moreover the individual citizen has much less scope for expressing her preferences through voting than the consumer has in the market-place. In theory all resources flow and adjust to the changing demands of market consumers; public choice theory suggests many ways in which the *political* process does *not* respond to the demands of citizens. In addition government action involves coercion which supposedly does not apply in market exchanges. Because collective decisions involve coercion and cannot satisfy all individual preferences equally, most public choice writers regard government as being intrinsically a less desirable means for satisfying individual wants than the market place, except for essential public goods. This conclusion is disputed by those who look to government to correct the inequalities and instabilities of the market place. This basic issue will recur later.

Basic assumptions: self-interest and rationality

A basic assumption of public choice thought is that individuals act as 'rational egoists' who pursue their private interests in both economic and political life. This is an arguable and slippery starting-point requiring elucidation. It will be convenient to deal with the two ideas of 'egoism' and 'rationality' separately.

The concept of self-interest

Ever since Adam Smith argued that it was the self-interest of butchers and bakers which (in a competitive market) promoted the general prosperity, it has been widely accepted that the market system works through the private pursuit of economic gain. This statement can be questioned. Other motives play a necessary part in economic life (see Chapter 7) and it can also be argued that the dominant role of self-interest is not so much the

cause as the *consequence* of competitive markets. If full competition truly existed, as the theorists propose, an individual trader would need to act purely self-interestedly in order to survive. Ironically 'rational economic man' then becomes not the freely choosing individual which public choice theorists celebrate but a mechanistic figure controlled by external forces (Hollis and Nell, 1975).

Even so the pursuit of private gain is generally pursued and (subject to some moral as well as legal constraints) legitimised within the market system. The ultimate motive need not be a selfish one; I may want to make a lot of money in order to give to charity or an ailing friend. However public choice writers stress that the market relationship itself is instrumental and impersonal in its nature. Market consumers look for the best buy and while a few individuals may (for example) boycott South African oranges, even a socialist will usually buy a hi-fi set on purely personal preference without regard to the labour policies or other practices of the company making it.

Do these same instrumental and self-regarding motivations apply also in politics? In the past even neo-classical economists have doubted the comparison. Edgeworth, one of the founders of this school, believed that self-interest was the first principle of economics but thought also that trade (like war) involved 'the lower elements of human nature' which need not apply elsewhere (Sen, 1982, pp. 84–8). No less a market advocate than Mrs Thatcher seemed to hold much the same view when she told the Church of Scotland (rather smugly) that, while the worthy clergy and she herself did not need the spur of large economic incentives, businessmen needed them if they were to generate wealth (Raban, 1989).

Public choice theorists reject this line of thought as mistaken and hypocritical. Why should private, personal interest cease to be relevant when a voter votes, an interest group campaigns, or a politician seeks office? Although they made reservations, for example conceding the existence of altruism, the early public choice writers took self-interest to be the most realistic assumption about political behaviour (Downs, 1957, pp. 27–8; Buchanan and Tullock, 1962, p. 30). A more recent study stays with the hypothesis that 'private interest will dominate decision making in a large number of cases' (Crain and Tollison, 1990, p. 3).

These contentions do not accord with popular ideas of how politics *should* be conducted. For example, Robert Lane's survey of American attitudes found that self-interest was viewed as

fruitful and beneficial within a market context, but as harmful and in need of constraint in a political one (Lane, 1986). On the other hand, public opinion tends also to be highly sceptical of the actual motivations and behaviour of politicians, bureaucrats, and so on. It is this 'credibility gap' to which public choice theory draws attention. The public's expectations of politics are held to be unrealistic. Public choice writers may have performed a service in seeking to expose some of the cant and self-interest which surrounds politicians' frequent appeal to the 'public interest', but their opposite assumptions may not be valid either.

Conflicting motives in politics

Altruism appears to be a much more widespread factor in political than in market behaviour. Certainly this is true of voting behaviour (see Chapter 2). In economic terms this means that an individual's own 'utility' is increased by contributing to the 'utility' of others, whether particular groups or the whole community. Public choice theorists explain this factor as a sort of 'psychic income', but this rather cumbersome explanation still weakens the concept of self-interest as a workable assumption. Self-interest can have little explanatory force unless it can be contrasted with altruistic behaviour.

Faced with much contrary evidence about political behaviour, Howard Margolis reverts to a dual explanation. Politics (he argues) exhibits both selfish and altruistic tendencies. However he retains economic methodology by suggesting that an individual will seek a balance between these tendencies and will experience diminishing utility if he or she becomes either too selfish or too altruistic (Margolis, 1982). There is some similarity here to Hirschman's suggestion of a public-private cycle, whereby individuals go into public life with altruistic motives or ideals, experience disillusionment, revert to the world of private interests and gain, find *that* in turn unsatisfying, and repeat the cycle (Hirschman, 1982). However, while Hirschman's account is at least suggestive about the existence of broad social cycles of political engagement and disillusion, Margolis' account offers a weak basis for predicting how individuals will behave in particular political situations.

Another important factor in political life, which does not have any parallel in the market-place, is the influence of ideology. Even if (very implausibly) ideology is defined or written off as