

How to Study for Chapter 11: Public Choice

Chapter 11 applies the prices of the market economy to the political aspect of society.

1. Begin by looking over the Objectives listed below. This will tell you the main points you should be looking for as you read the chapter.
2. New words or definitions are highlighted in italics in the text. Other key points are highlighted in bold type.
3. The class meeting will cover the technical points relating to Public Choice. You are responsible for all of the cases whether they are covered in class or not. Be sure to go over them carefully to see how they illustrate the principle.
4. You will be given an In Class Assignment and a Homework assignment to illustrate the two main concepts of this chapter. When you have finished the text and the assignments, go back to the Objectives. See if you can answer the questions without looking back at the text. If not, go back and re-read that part of the text. Then, try the Practice Quiz for Chapter 11.

Objectives for Chapter 11: Public Choice

At the end of Chapter 11, you should be able to answer the following:

1. What is meant by “*public choice*”?
2. What is meant by “*rational abstention*”? by “*rational ignorance*”? In each case, explain why they occur.
3. What is a “*special interest*”? What is the “*special interest effect*”? Explain under conditions of widespread costs and concentrated benefits. Explain under conditions of widespread costs and concentrated benefits.
4. What is the “*shortsightedness effect*” and why does it occur?
5. What is a “*bureaucracy*”? What are the main goals of bureaucrats? In what ways might bureaucracy lead to non-optimal behaviors from the point of view of society?
6. What is meant by “*empire building*”?
7. Explain how the Forest Service illustrates the problems inherent in bureaucracy.
8. What criticisms can be made of Public Choice Theory?

Chapter 11 Public Choice (latest revision June 2004)

In Chapter 10, we discussed the functions of government in a market economy with *laissez faire*. We also considered some examples of each. It was argued there that government has a role to play when the market fails to perform properly. In Chapter 11, we shall consider the arguments of what is called **Public Choice Theory**. **In this theory, the government may also fail to perform its functions properly.** In many of these cases discussed in this chapter, the government failed to perform its function properly, causing certain problems for society. Public Choice economics applies the principles of private markets to the government. In fact, it commonly refers to the government as the “**political market**”. In this “market”, the desires of people are satisfied through collective decision-making. There are two important principles of private markets that are applied to government. **First, individuals are the basic decision-making units.** Government agencies are composed of individuals. **Second, individuals attempt to achieve their personal goals in this “political market”.** Legislators act as

maximizers; in this case, they attempt to maximize the number of votes in the next election. Bureaucrats act as maximizers; in this case, they attempt to maximize the size and budget of their agency. And private individuals act as maximizers; they attempt to use the government to maximize their own well being. While Public Choice has generated a vast literature, there are three aspects we shall focus on here.

(1) Voting Behavior

One phenomenon commented on frequently these days is the small percent of people who choose to vote. Of the voting age population, not much more than half vote in presidential elections and not much more than one third vote in congressional off-year elections. To the public choice economist, this is not surprising. **First of all, these economists assume that people act in their own self-interest. Therefore, you vote based on what you believe will be best for you** (this, of course, does not preclude the possibility that your self-interest is to have the best for the country). **As a rational person, you compare the marginal benefits and the marginal opportunity costs of going to vote.** The marginal opportunity cost is the time that must be spent going to the polls, standing in line, casting the vote, and then returning home. More important is the time that must be spent to gain the information necessary so that you can vote for what is best for you. You must read the ballot, study the issues carefully, listen to the various candidates, and discuss with others. The problem is that the marginal benefit is likely to be low. The reason is that a single vote has little chance of affecting the outcome. Unless you know that there is a race like a 1994 congressional race in Connecticut (the incumbent congressman won by only four votes) or the 2000 Presidential election in Florida, the results of the election will be the same whether you vote or not. Knowing this, a rational person may choose not to vote. Public Choice economists call this *"rational abstention"* and argue that it should not be confused with "apathy" (to abstain means to refuse to participate). Voters do care very much about the election outcome; they simply realize that the results of the election will be the same whether they vote or not. **Rational abstention is very damaging to the argument on behalf of democratic government, since elections may not determine the true will of the people in the society.**

If it is rational to not vote, why do some people vote at all? Two reasons are commonly suggested. One is that people get great benefit from just being able to vote, even if their individual vote will make little difference to the outcome. After all, only a minority of people on earth has the right to vote. The other reason that people vote is the result of social pressures from friends, family, colleagues at work, and so forth. These people want you to vote, since your self-interest and their self-interest are likely to be the same. They will be angry if you don't vote.

Just as it is rational not to vote, it is rational not to be informed of the issues. Public Choice economists called this *"rational ignorance"*. The value of the time (and possibly the money) given up to get the information to make an informed vote can be large. If one's vote will have little effect on the outcome of the election, the marginal benefit is likely to be low. Therefore, it is rational for people to be poorly informed about the issues. **Those who do vote commonly look for "shortcuts" to be able to greatly lower the costs of acquiring information.** We shall mention two such shortcuts here. One is the use of **political parties**. Knowing that a candidate is a Democrat or a Republican tells a voter much of what he or she needs to know. Indeed, some argue that this is the main function played by political parties today. The disagreements within

each party are so vast that they might cease to exist if it were not for this information function. Second, is the use of **single-issue voting**. People will learn a candidate's view on one issue and assume from this that they can predict the candidate's view on many others. Issues that have served this function in recent years include the War in Vietnam, abortion, gun control, social security, the War in Iraq, and so on.

(2) The Special Interest Effect

There are only two ways for a person to gain income. One is to contribute to the revenue of one's employer. That is, one earns income by producing new wealth. **The other is to find a way to have income redistributed from someone else to oneself.** In this case, there is no new wealth; one person's gain is the other person's loss (known to economists as a "*zero sum game*"). Some of this redistribution involves transfers to people who cannot be expected to contribute new wealth: the elderly and the disabled. But some of it involves transfers that have little justification. There are many ways for these transfers to be accomplished. We shall focus here on transfers created through government actions. *We will define a special interest as a group that uses the political process to gain an increase in its income at the expense of others.*

(a) Concentrated Benefits with Widespread Costs

We have assumed that people undertake an activity as long as the marginal benefit exceeds the marginal opportunity cost of doing so. *Special interests will likely be successful at using the government for their own gain if the benefits of the government activity are concentrated in a small number of people, each of whom receives a large individual benefit, while the costs are spread over many people, each of whom pays a small cost.* As an example, let us go back to the case of price supports for agriculture. As we showed, these programs raise the price of food. They also cost taxpayer money that could be used for other purposes (a tax cut or another government program). The price supports cause farmers to grow food that nobody wants to eat. This is inefficient, to say the least. Economists almost universally oppose such programs. So why has this program existed for sixty years? The answer involves the special interest effect. **Farmers represent a special interest.** The programs have brought each farmer in America an average gain of between \$10,000 and \$15,000 each year. (Since many farmers received nothing at all from the program, other farmers must have received many tens of thousands of dollars of payments.) These farmers are willing to lobby Congress for this program as long as the cost per farmer is less than the amount of the payments. (To *lobby* is to promote a program directly with a Congressperson, Senator, or other government official.) On the other hand, these programs cost each American an average of perhaps \$100 to \$150 per year in higher taxes and higher food prices. And most people are unaware of this. As long as lobbying Congress costs more than this amount, people will not get involved to stop the programs. (Large lobbying groups also face the **public goods problem**; I will not contribute to the lobbying effort because I hope that others will do so. If they do, I can get all of the benefits without paying for them.) **Farmers lobby Congress heavily on their behalf while few are there to lobby against them. The programs continue to grow despite the fact that many more people are hurt than are helped by them.**

There are many other examples of this phenomenon. Wool producers are given subsidies that, in 1990, were 127%. This means that a farmer who sold wool in the market for \$1000

would get a check from the government of \$1270. For producers of mohair, sales of \$1000 once would generate a government check of \$3870. (This was eliminated in 1993.) Sugar is kept from entering the United States so that it can sell here for a price perhaps ten times the price found in the rest of the world. The automobile companies and their workers were able to convince President Reagan to "persuade" Japan to "voluntarily" reduce the number of Japanese cars sold in the United States. This raised the price of Japanese cars by an estimated \$2,500 and the price of American cars by an estimated \$1,000. And so on.

The phenomenon of the special interest effect has become especially significant in the post-World War II period. In part, this is due to the growth of population and the expansion of television. **Congressional districts and states are larger; one can no longer campaign for public office by going door to door. This has made it more necessary to campaign on radio and television, requiring the individual to raise more money.** In part, it is due to the changes in the way Congress is organized. **The growth of the committee system, and especially the power of committee chairs, has made lobbying less expensive for special interests.** Instead of trying to gain favor of 218 Congresspersons, a special interest need only gain the favor of a few members of the appropriate committee. And, in part, it is due to the weakening of political parties.

Case 1 on the Special Interest Effect: International Trade

Suppose there is a policy decision that would increase trade between countries. For example, consider a policy decision to lower American tariffs (taxes on imported goods). Such a policy would have certain **"losers"** in the United States --- the companies (and the workers in those companies) who make products that compete with the imported products. Such a policy would also have **"winners"**. "Winners" would include the American consumers who would now have more goods available to buy. Because of a greater supply of goods and because of greater competition, the prices paid by American consumers would also likely be lower. As we will see in Chapter 27, the gains from opening trade by lowering tariffs exceed the costs. The vast majority of economists agree with the proposition that opening trade by lowering tariffs is good for America on balance. *Yet as we have just seen, those hurt by a policy of reducing tariffs are a relatively small number of people. However, each is hurt greatly. Therefore, they will be politically involved to defeat the policy of lowering tariffs. Those who gain from the policy of lowering tariffs are a very large, diffuse group. Each person gains very little. Therefore, the beneficiaries are not likely to be politically involved to have the policy of lowering tariffs succeed.* The result is that a policy of lowering tariffs is likely to be defeated. The problem is how to figure out a system to make it politically feasible to have good economic policies?

In 1934, a very high tariff was indeed passed. Named for the two members of Congress who originally proposed it, it was called the **Smoot-Hawley Tariff**. It has since been universally recognized as a very poor economic policy. Because of the disastrous effects it caused, Congress created a system to try to overcome the special interest effect. There are three parts to this system. *The first part is to try to enlist the support of the "winners" to act politically on behalf of tariff reduction.* This support is to offset the influence of the "losers" in trying to defeat tariff reduction. *Support from the "winners" is enlisted by having tariff reductions be achieved through mutual agreement between nations.* From the 1960s through the 1990s, there were

several “rounds” of trade talks between nations in which tariffs were reduced. The idea here, for example, is that the United States would not reduce its tariffs against products made in Germany unless the Germans would also agree to reduce their tariffs against products made in the United States. In these talks, those hurt by imports from Germany would be politically involved in trying to defeat the reduction in American tariffs. But those who benefit by exporting products to Germany would be politically involved in trying to have the talks succeed. The pressure from the exporters would offset the pressure from the importers and would allow the lawmakers to make the decision that is economically better for the nation as a whole.

The second part of the system to overcome the special interest effect is for Congress to find a way to “pass the buck” to someone else. In the American Constitution, Congress has the sole responsibility for “regulating commerce with foreign nations”. Despite this, **Congress delegated the ultimate responsibility for trade matters to the Executive Branch (that is, to the President)**. It did so by authorizing a special trade representative (called the United States Trade Representative). That person negotiates the trade deals with other countries. Congress has chosen to create a system whereby it ultimately approves the deal negotiated by the U.S. Trade Representative as a whole or rejects it as a whole. Congress cannot amend the negotiated deal. The U.S. Trade Representative works for the President. The President is the only person elected by the entire country. So the President has to consider the interests of the entire country, not just the interests of a specific region or industry. When industry leaders go to Washington to complain that they are being hurt by imported products, the members of Congress simply refer them on (“pass the buck”) to the U.S. Trade Representative. Indeed, members of Congress can argue vociferously for trade restrictions, knowing that no such restrictions would ever occur. As people might say today, the members of Congress can “talk the talk” knowing that they would never have to “walk the walk”.

The third part of the system to overcome the special interest effect is to try to reduce the opposition of the “losers” from the policy of lowering tariffs. This has been accomplished by reducing some of the damage that can be done to them. One way the damage is reduced is through **Trade Adjustment Assistance**. Workers who lose their jobs because of an increase in imports can receive financial help as well as retraining and relocation assistance. Another way the damage is reduced is to allow the tariffs to be re-imposed if the American companies are hurt by practices of foreign companies that are considered “unfair”. We will consider the case of “dumping” in a later chapter.

The system that was developed did not lead to completely free trade. The United States has consistently had special protection for textiles, steel, certain agricultural products, and automobiles. **But on the whole, the system has allowed the American government to be a leader in the promotion of freer trade around the world, despite the special interest effect.** In the 1970s and 1980s, the system became quite threatened. As the American economy became more and more involved in the world economy, more and more Americans became potential “losers”. And there was considerable concern that companies in foreign countries (especially Japan) were being subsidized by their governments or were engaging in “unfair trade practices”. It is ironic that there were more trade restrictions imposed during the first term of President Reagan (1981 to 1985) than any other recent president, even though President Reagan was perhaps the most supportive of free markets of any president. Yet, despite the threats, the system as described here survives today. The United States is still leading the world in the promotion of free trade, with the next agenda item being a possible Free Trade Area of the Americas.

Case 2 on the Special Interest Effect: Privatization in Russia

Russia became a democracy in 1992, following the failure of the coup of August 1991. At the time of the failed coup, the communist system collapsed completely. Under the communist system, all enterprises had been owned by the government (and were called state-owned enterprises). The new leaders of democratic Russia desired to shift to a market system. This meant that the state-owned enterprises were to be “privatized” (shifted to private ownership). The collapse of communism and the shift of the Russian economy toward a market system are the subject of Chapter 28. Here, let us consider just the politics of privatization.

There were four groups who opposed the privatization of the Russian state-owned enterprises. Each was able to bring considerable political pressure to stop the privatization. Those who supported privatization believed that privately owned enterprises would produce better products and would be more efficient in producing them. **But those who would benefit from the better and cheaper products were a large, diffuse group. They would not be politically involved to try to have the privatization achieved.** Indeed, polls showed that a majority of Russian citizens disapproved of the private ownership of large enterprises. Therefore, one would expect that privatization would not be undertaken by a democratic government. But that is not what occurred. By 1994, 80% of the 20,000 eligible medium and large enterprises had been converted into private ownership.

Privatization was achieved in Russia by finding ways to either reduce the opposition of the opponents or by finding ways to make the opponents into supporters. One set of opponents was the **industrial ministries** (headed by a person with the title of “Minister”). There is nothing equivalent to an industrial ministry in the United States. Each industrial ministry is a part of the Russian government directly in charge of a specific industry. Under the communist system, the Ministry appointed the directors of the enterprises in that industry, set production quotas for each enterprise, set prices, determined what materials would be allocated to each enterprise, determined where each enterprise would deliver its products, and so forth. Some of these powers had been weakened in the later part of the communist period, under Gorbachev. **The opposition of the ministers was diminished by assuring them that enterprises in strategic industries such as energy and defense would not be privatized without their agreement and that railroads, education, and health care would never be privatized. This limited the reduction of their power that would come from privatization.**

A second group opposing privatization were the enterprise directors. And a third group opposing privatization were the workers in the enterprises. Privatization was therefore structured to gain their support. **Workers and directors could buy 51% of the voting shares of a new private enterprise at a discount.** They had first claim on the stocks of their own enterprise. They could even use enterprise funds to make the purchase. By the end of 1994, some 59% of the shares of the newly-privatized enterprises were owned by workers or directors (9% by the top management). Having the new private enterprises controlled by their workers and directors can be quite inefficient. Such control makes it hard to fire unnecessary workers or get rid of inefficient managers and makes it likely that wages will be raised. But in Russia, this solution was necessary in order to gain the political support of the directors and the workers (a very large group). Whatever inefficiency results from having enterprises controlled by their directors and workers is less than the inefficiency that results from government ownership.

The last group of opponents was the leaders of regional and local governments. They had become more powerful under the Gorbachev reforms of the late 1980s. **Their support was gained by giving them control over privatization of small enterprises within their regions.** So, most shops and many small enterprises were sold by the regional or local governments for cash. And for some of the larger enterprises, the regional governments could have some of the shares of stock to re-sell later.

Finally, the opposition of the public was overcome by giving them vouchers. Russian citizens could buy a voucher for 10,000 rubles (\$28) at a cost of 25 rubles (\$.07). 97% of the population bought these vouchers within 4 months. These vouchers could be sold for cash in a private market, used to buy stock in specific companies, or used to buy into an investment fund (similar to a mutual fund in the United States).

The Russian privatization was much more extensive and occurred in a shorter time than most people had predicted was possible. Its good points and its bad points will be considered in Chapter 28. Here, we see the techniques used to overcome the special interest effect and make the privatization politically feasible.

Test Your Understanding.

Return to the case of the Mining Law in Chapter 10. Use the principles of this section to explain why the Mining Law of 1872 is still basically in place today. That is, why has it been so hard to reform when it has so many obvious disadvantages to society? If one wanted to eliminate it, what techniques might be suggested to overcome the special interest effect?

(b) Widespread Benefits and Concentrated Costs

We can reverse our result *if the benefits of a program go to a large number of people, with each person gaining a small personal benefit, while the costs of a program are borne by a small number of people, each paying a large cost. In this case, programs for which the overall benefits exceed the overall costs are not undertaken.* Those receiving the benefits do not find it worthwhile to lobby government for the program whereas those paying the costs do find it worthwhile to lobby government to prevent the program.

Let us take an example. Recent laws and court rulings have reduced the amount of old-growth forestland on which timber can be cut. The reduction is considerable; the total amount cut was dramatically reduced from almost 12 billion board feet in the 1980s to less than 6 billion in 1994. The reason for the ruling is the spotted owl. The California and Northern spotted owls are what are called "management indicator species". Because they require a considerable area to be able to survive (around 3,000 acres per pair, depending on the location), their decline is considered a good indicator that the entire ecosystem is in decline. One study has attempted to measure the benefits to society and the opportunity costs of restricting logging on old-growth forests. (We shall soon discuss how these benefits can be measured.) It found that the benefits to society were at least 3 1/2 times the costs. Thus, it is clear that this policy is good for the society as a whole. **However, the benefits are spread over millions of people. To the large majority of these people, the benefits they received personally were valued at less than \$100. On the other hand, the costs are concentrated in a few people.** Logging companies and their workers are hurt the most. People whose business involves selling to logging companies are also hurt. Since towns near forests are generally small towns whose business is mainly related to logging, other businesses in the town are likely to be hurt as well. As one can guess, these people are strong lobbyists to reverse the program and allow more logging. It

should hardly be surprising that virtually every Congressperson from Oregon, Washington, and Northern California favors an increase in logging. Logging was reduced only when the courts intervened.

(3) The Effects of Time

The same reasoning applies when **the benefits come in the present while the costs are paid in the distant future (or when the costs come in the present while the benefits come in the distant future)**. This is called *the shortsightedness effect*. To some people, it is a result of the need for re-election. Thus, politicians look ahead no more than two years (for Congresspersons), six years (for Senators), and four years (for the President). To other people, this is a result of the fact that people value the present much more than the future. For whatever reason, **politicians tends to favor programs that have benefits that appear in the present and costs that will be paid in the distant future. And they tend to oppose programs that have costs that are paid in the present while the benefits will not arrive until the distant future.**

(4) Bureaucracy

Most government agencies are bureaucracies. (Many large private companies are also bureaucracies; we shall be concerned with these later.) While legislatures pass the laws, it is the bureaucracies that administer these laws. *We will define a bureaucracy as an organization that produces a product that is not sold through a market and which obtains at least part of its revenue from sources other than the sale of its product (usually from taxes)*. The traditional view of a bureaucracy in a democracy derives from the famous sociologist Max Weber. He saw bureaucrats as knowledgeable, talented people who objectively administer the laws. More recently, "bureaucrat" has come to be a dirty word. Bureaucrats are seen as bungling, inefficient, and uncaring. Public Choice economists reject both of these views. They see bureaucrats as self-interested, rational, maximizers. **In this view, bureaucrats act to maximize their own welfare. Their welfare depends on salary, perquisites, status in the agency and number of subordinates (power), size of the budget over which one has control, and non-monetary benefits (the quiet life)**. All of these are enhanced when the agency is growing. *Thus, in this view, the main incentive is to maximize the size of the agency (known often as "empire building")*.

Because the agency's output is not sold in a market and because it receives revenue from sources other than sale of the product, the agency does not have to meet the same conditions of efficiency that a profit-maximizing company has to meet. In the view of Public Choice economists, *both the size of the agency and its budget are commonly expanded well beyond the size that would be economically optimal*. In a bureaucracy, there is nothing that compares to the owner of a private company. That is, if the agency earns a profit from its activities, there is no one who stands to benefit. *As a result, any excess of revenues over expenditures commonly shows up as added expenditures*. For one example, hospitals are notorious for over-investing in equipment that is then underutilized. And many university athletic departments have income of more than \$40 million per year. Yet they constantly claim they are losing money. Where does this money go? The answer commonly is a Hall of Champions or new office for the coaches or "recruiting trips" to find the best players in Hawaii and the Caribbean. (Indeed, if a bureaucracy has not spent all of its allotted funds by the end of the year, there is great pressure to see that it

all is spent. It does not matter that the spending is for things that are relatively unimportant. Funds not spent this year will mean a reduced budget for next year.)

To understand bureaucratic behavior, a public choice economist would look at the structure of incentives. What is necessary for the agency to be able to increase in size and in budget? When those activities are identified, the public choice economist will feel comfortable predicting how the agency will behave. Many people argue that these behaviors have often been economically and environmentally destructive. Let us examine just one example.

Case on Bureaucracy: The Forest Service

The Forest Service, under the Department of Agriculture, controls 18% of commercial forestland in the United States (191 million acres in all). National forests account for 21% of the entire state of California. The Forest Service employs over 30,000 people and has a budget of \$3.4 billion per year.

According to the Multiple Use - Sustained Yield Act of 1960, the forests are to be managed for a variety of uses including outdoor recreation, timber, range, watershed, and wildlife and fish. The 1976 National Forest Management Act placed even further restrictions on the Forest Service. Streams had to be protected to preserve fish habitat. Diversity of plants and animals had to be protected. And harvesting had to follow a "non-declining even flow" standard, meaning that the amount of timber harvested must be an amount that can be maintained indefinitely.

To harvest timber, the Forest Service must first offer it for sale. This requires an expenditure of money (about \$90 per thousand board feet cut) and therefore must go through the federal government's budgeting process. The President prefers high sales of timber to keep wood prices low to stimulate home construction. Members of Congress like to see high harvest levels to keep the mills in their local districts (and their workers) producing at a high level and to fund schools and other local services (25% of the receipts from timber sales are returned to local governments). In the late 1980s, it was not uncommon for the Forest Service to be given more money than it had even requested.

As noted, the Forest Service is required to balance the pressure for high levels of timber harvesting with the requirements of the law that there be "non-declining even flow". It does so by calculating what is called **the "allowable cut effect (ACE)"**. In doing this, it "assumes" that fertilization, thinning, brush control, and so forth will increase yields in the future. Since more will be available in the future, more can be cut today without violating the requirement that the amount harvested be maintained indefinitely. The future increases in yields, of course, often are not realized and the forests begin to show the effects of over-cutting.

To repair the forests, the Knutson-Vandenberg Act (K - V) allows part of the receipts from the timber harvest to be used in reforestation projects. While the purpose of repairing the forests seems commendable, the result has been to increase timber cutting (to bring in more funds). If a forest manager has a desired project, Congress may not provide the necessary money. In this case, some trees will be cut just to generate K - V funds.

What is most surprising to some is that most of the sales of timber from public lands come from marginal lands where **the income from the sales is less than the expenses the Forest Service incurs in putting the timber on the market**. On 80% of national forests, sales of timber by the Forest Service lose money. One study found that, in 2000, 85% of the total economic value generated by U.S. national forests comes from recreation or from fish and

wildlife benefits. 88% of the employment is also related to these. Only a small portion of the economic benefits to society of the national forests come from timber. Yet, trees have been cut on lands that would have more appropriately been allocated to wildlife, fisheries, or recreation. **How can we explain an agency that over-cuts the forest, with harmful effects on the environment, in order to lose money? The answer, of course, lies in the incentives to cut timber noted above.** The Forest Service receives money for the trees that are cut; it receives very little money (21% of its budget) for recreation and no money at all for land preserved for wildlife. **The Forest Service increases its own budget when it sells trees to be cut, even if the sales lose money overall.**

In the late 1980s, the Forest Service began to change. Environmental concern has been increased. In 1993, the Forest Service came out with "option 9" (upheld by the courts in 1994). This calls for dramatic reductions in the level of harvesting. It specifically stated that "previous Forest Service plans have significantly overestimated the amount of timber available for harvest each year, presenting unrealistically high harvest levels that cannot be sustained".

Test Your Understanding -1

What do you think would result if the Forest Service charged a day-use entry fee for recreational use of the forests (or an annual pass) and the Forest Service were allowed to keep this money as its main source of revenue? It has been estimated that a charge of \$3 per day would raise \$6 billion to \$11 billion per year, much more than is raised by timber cutting.

***Test Your Understanding - 2*.**

The class described bureaucracies and made the assumption that people in bureaucracies respond to the incentives they are provided. Your college is a bureaucracy. Here is a brief description of the incentives:

- (1) The Board of Governors (5 people) are elected by the people for four-year terms.
- (2) The administration is paid a fixed salary (on a scale). There are few promotion possibilities for administrators, but some can gain promotion by moving to other colleges. Administrators can be fired as administrators but have tenure with the college. (If fired, an administrator becomes a teacher.)
- (3) The teachers have tenure (cannot be fired except for cause, after a four year probation period) and are paid on a fixed salary scale. Teachers have very few promotion opportunities and rarely leave employment before retirement..
- (4) The clerical and other employees (called "classified") are paid on a fixed scale that depends on the type of job. These people have more promotion opportunities than teachers, but lower pay. After a brief period, they can only be fired for cause.
- (5) The amount of money received by the college depends on the number of units taken by students. Up to a limit, the college receives a certain number of dollars for each student. These dollars are then allocated to each area of the college in proportion to its size.

Based on these incentives, what kinds of behaviors would you expect to see? Relate your answer to any experiences you have had with the college.

***Test Your Understanding - 3*.**

Consider grazing range land of the West. Since the 1930s, this land has been state property. The agencies that manage these lands (over 20% of all land in California) are the Bureau of Land Management (BLM) and the Forest Service. Nationally, nearly 7 million cattle, sheep, and horses authorized to graze on public lands. To be able to do so, the owner must get a grazing permit or lease from the government agency. There are only 27,000 individuals, partnerships, or corporations in the United States that have such permits and 27% of those use 87% of the land. Trampling by cows compacts the soil and adds to problems of runoff during rainstorms and of erosion.

(1) It has been estimated that ranchers pay the government a fee to graze their animals that is about 1/4 of the fee that would be charged in a free market. The government loses an estimated \$120 million per year (spending \$150 million but receiving only \$30 million in fees). The government also pays half of the costs of feed that ranchers buy if there happens to be a drought. And, ranchers pay only a small part of the cost of providing water, much of which is used to grow hay and alfalfa. Use the principles of Public Choice to explain why these subsidies to ranchers would occur?

(2) About half of the fees that the ranchers do pay are used by the government agencies for range improvements. Use of these monies is under the discretion of the agencies and is not closely monitored by Congress. Most of these improvements end up costing far more than they are worth either to the ranchers or to the government. (For every \$4 the BLM spends managing the range lands, the ranchers earn only \$3.) Use the Principles of Public Choice to explain why this overspending would occur.

(3) Those who graze their animals on the public land must graze all the animals required in their permits. If they do not, they lose the permit (**use it or lose it**). Losing the permit would reduce the value of their privately owned ranch. (Indeed, only those who own ranches adjacent to public lands are able to obtain permits.) They cannot sell their permits to those who might want to use the public lands for recreation. What do you believe would result from these incentives?

(4) It has been estimated the recreational use of BLM land is worth 9 times the value of the land for forage. Why does the BLM not use the land to provide recreation? What changes could be made to induce the BLM to focus more on recreational use of the land?

Test Your Understanding. - 4

The reading describes the U.S. Forest Service. A similar bureaucracy, the **National Park Service**, is part of the Department of the Interior. It manages some 400 national parks and 87 million acres. The most famous are Yellowstone and Yosemite. Others you may be familiar with are the Grand Canyon, Sequoia - Kings Canyon, and Death Valley . The National Park Service has a budget of about \$1.5 billion, funded by Congress. Below are some of the criteria by which the National Park Service is run. What do you believe will result from these criteria? WHY?

(1) The total amount of money appropriated by Congress is divided among the parks according to the number of visitors in each park.

(2) Congress specified that charges to users of the park be low. The average park charges users about \$0.60 per visitor day. It has been estimated that the market value is actually \$14 per visitor day. The Park Service is only allowed to keep a small part of the fees collected by the parks.

(3) There are about 500 businesses that have concessions in the national parks. They run hotels, stores, restaurants, tour guides, etc. At present, they pay about 2.5% of their sales receipts to the Park Service for the right to operate in the parks. Payments of 10% to 15% are commonly charged in other activities. The Park Service is not allowed to keep any of the concession receipts.

(4) Many of the national parks are facing severe ecological damage. In addition, maintenance has been deferred in many parks, leading to roads, sewage, and buildings in disrepair. (In Yellowstone, 90% of trails and 80% of roads are in need of repair.) Yet, while this was occurring, 33 new areas were added to the national park system. And hundreds of millions of dollars were spent on visitors' centers (each about the size of three large homes and costing about \$8 million). Use the principles of Public Choice to explain inefficient spending occurring while other, more important, spending is not done.

Criticisms of Public Choice

In general, the public choice theory has remained controversial in Economics. It seems too simple. There are too many cases of politicians and bureaucrats acting in what they perceive to be the public interest and against their own personal interests. And the assumption that bureaucrats act only to maximize the size of their agencies has not been demonstrated in empirical studies. Yet, there is a lesson here. *Government may fail to provide socially optimal*

results, just as markets may fail. Whether we should rely on markets or on the government may depend on the circumstance. When we do ask government to do something, we need to carefully analyze the incentives facing those with decision-making power inside government to be certain that those incentives lead to the behaviors society desires.

Practice Quiz on Chapter 11

1. According to **Public Choice Theory**, many people are unlikely to vote because:
 - a. special interests force many people not to vote
 - b. people are shortsighted
 - c. the marginal benefit of voting is perceived as less than the marginal opportunity cost
 - d. bureaucrats actually run the government
2. According to **Public Choice Theory**, why is the farm program enacted when the gains to society from it are much less than the costs to society?
 - a. the benefits are concentrated while the costs are widespread
 - b. the benefits are widespread while the costs are concentrated
 - a. the benefits and costs are both concentrated
 - b. the benefits and costs are both widespread
3. The fact that people find it appropriate not to inform themselves about issues or candidates is called
 - a. rational abstention
 - b. rational ignorance
 - c. bureaucracy
 - d. special interest effect
4. In Public Choice Theory, the goal of a **bureaucracy** is assumed to be
 - a. maximizing profits
 - b. growth
 - c. serving the public well
 - d. being as efficient as possible

Match the following definitions.

- | | |
|---------------------|----------------------------|
| 5. Bureaucracy | 8. Shortsightedness Effect |
| 6. Special Interest | 9. Public Choice Theory |
| 7. Empire Building | 10. Rational Abstention |
- a. An organization that receives most of its income from the government and not from the sale of a product
 - b. People don't vote because the marginal benefit of voting is perceived to be less than the marginal opportunity cost
 - c. A group that uses the government to gain income at the expense of other people
 - d. A theory based on the assumption that political leaders act to maximize their own self-interest
 - e. The desire to become as big as possible, even beyond the size that might be best for society
 - f. Thinking ahead only a few years and not doing things that might be desirable in the long run

Answers: 1. C 2. A 3. B 4. B 5. A 6. C 7. E 8. F 9. D 10. B