

Public Choice III

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Contents

<i>Preface</i>	<i>page xvii</i>
1 Introduction	1
Part I Origins of the state	
2 The reason for collective choice – allocative efficiency	9
2.1 Public goods and prisoners’ dilemmas	9
2.2 Coordination games	14
2.3 Public goods and chickens	16
2.4* Voluntary provision of public goods with constant returns to scale	18
2.5* Voluntary provision of public goods with varying supply technologies	22
2.6 Externalities	25
2.7 The Coase theorem	27
2.8 Coase and the core	30
2.9 A generalization of the Coase theorem	32
2.10 Does the Coase theorem hold without predefined property rights?	34
2.11 Externalities with large numbers of individuals	35
2.12 Externalities with large numbers of individuals – a second time	39
2.13 Experimental results in the voluntary provision of public goods	40
3 The reason for collective choice – redistribution	44
3.1 Redistribution as insurance	45
3.2 Redistribution as a public good	47
3.3 Redistribution to satisfy fairness norms	49
3.4 Redistribution to improve allocative efficiency	51
3.5 Redistribution as taking	53
3.6 Income transfers in the United States	56
3.7 Redistribution and the distribution of income	58
3.8 Redistribution to special interests	61
Part II Public choice in a direct democracy	
4 The choice of voting rule	67
4.1 The unanimity rule	67
4.2 Criticisms of the unanimity rule	72
4.3 The optimal majority	74
4.4 A simple majority as the optimal majority	76

5	Majority rule – positive properties	79
5.1	Majority rule and redistribution	79
5.2	Cycling	84
5.3*	The median voter theorem – one-dimensional issues	85
5.4	Majority rule and multidimensional issues	87
5.5*	Proof of the median voter theorem – multidimensional case	92
5.6	Majority rule equilibria when preferences are not defined in spatial terms	94
5.7*	Proof of extremal restriction – majority rule theorem	95
5.8	Restrictions on preferences, on the nature and number of issues, and on the choice of voting rule that can induce equilibria	97
5.8.1	Preference homogeneity	97
5.8.2	Homogeneous preferences and qualified majority rules	99
5.8.3	The relationship between numbers of issues and alternatives and the required majority	103
5.9	Logrolling	104
5.10*	Logrolling and cycling	108
5.11	Testing for logrolling	109
5.12	Agenda manipulation	112
5.12.1	Agenda control in a spatial environment	112
5.12.2	Agenda control in a divide-the-cake game	113
5.13	Why so much stability?	114
5.13.1	Issues are indeed of one dimension	115
5.13.2	Voting one dimension at a time	116
5.13.3	Logrolling equilibria	118
5.13.4	Empirical evidence of cycling	120
5.13.5	Experimental evidence of cycling	123
6	Majority rule – normative properties	128
6.1	Condorcet’s jury theorem	128
6.2	May’s theorem on majority rule	133
6.3*	Proof of May’s theorem on majority rule	135
6.4	The Rae-Taylor theorem on majority rule	136
6.5	Assumptions underlying the unanimity rule	137
6.6	Assumptions underlying the two rules contrasted	138
6.7	The consequences of applying the rules to the “wrong” issues	140
6.7.1	Deciding improvements in allocative efficiency via majority rule	140
6.7.2	Deciding redistribution by unanimity	143
6.8	Conclusions	144
7	Simple alternatives to majority rule	147
7.1	The alternative voting procedures defined	147
7.2	The procedures compared – Condorcet efficiency	148
7.3	The procedures compared – utilitarian efficiency	151
7.4	The Borda count	152
7.4.1	Axiomatic properties	152
7.4.2	The Borda count and the “tyranny of the majority”	154
7.4.3	The Borda count and strategic manipulation	155
7.5	Approval voting	156
7.6	Implications for electoral reform	157

8	Complicated alternatives to majority rule	159
8.1	The demand-revealing process	160
8.1.1	The mechanics of the process	160
8.1.2	Vernon Smith's auction mechanism	168
8.2	Point voting	169
8.3*	An explication of the Hylland-Zeckhauser point-voting procedure	170
8.4	Voting by veto	174
8.5	A comparison of the procedures	179
9	Exit, voice, and disloyalty	182
9.1	The theory of clubs	183
9.2	Voting-with-the-feet	186
9.3	Global optimality via voting-with-the-feet	189
9.4*	Clubs and the core	194
9.5	Voting-with-the-feet: empirical evidence	199
9.6	Voluntary association, allocational efficiency, and distributional equity	202
9.7	The theory of revolution	204
Part III Public choice in a representative democracy		
10	Federalism	209
10.1	The logic of federalism	209
10.1.1	The assignment problem	209
10.1.2	Federalism with geographic representation	212
10.2	Why the size of government may be "too large" under federalism	213
10.2.1	Logrolling	213
10.2.2	Universalism	215
10.3	Intergovernmental grants under federalism	215
10.3.1	Intergovernmental grants to achieve Pareto optimality	216
10.3.2	The empirical evidence on intergovernmental grants	221
10.4	Why the size of government may be "too large" and "too small" under federalism	223
10.5	The problem of centralization under federalism	227
11	Two-party competition – deterministic voting	230
11.1	Outcomes under two-party democracy	231
11.2	Two-party competition in a constrained policy space	236
11.2.1	The uncovered set	236
11.2.2	The uncovered set with high valence issues	240
11.3	Relaxing the assumptions of the Downsian model	241
11.3.1	Candidates have preferences over policies	241
11.3.2	Candidates can enter and exit the contests	242
11.4	Testing the median voter hypothesis	243
11.5	Are local public expenditures public or private goods?	246
12	Two-party competition – probabilistic voting	249
12.1	Instability with deterministic voting	249
12.2	Equilibria under probabilistic voting	252
12.3	Normative characteristics of the equilibria	253
12.4	Equilibria with interest groups	255
12.5	An application to taxation	257

12.5.1	The logic	257
12.5.2	The evidence	259
12.6	Commentary	260
13	Multiparty systems	264
13.1	Two views of representation	264
13.2	Selecting a representative body of legislators	265
13.3	Proportional representation in practice	266
13.4	Electoral rules	266
13.4.1	The Hare, Droop, Imperiali, d'Hondt, and Sainte-Lagué formulas	267
13.4.2	The single-transferable vote (STV)	269
13.4.3	Limited voting	270
13.4.4	Single-nontransferable-vote systems (SNTV)	271
13.5	Electoral rules and the number of parties	271
13.6	Electoral rules and the degree of proportionality	276
13.7	The goals of parties	278
13.7.1	Coalition theories with a one-dimensional issue space	280
13.7.2	Coalition theories with two- or more-dimensional issue spaces	285
13.7.2.1	The political heart	285
13.7.2.2	The dimension-by-dimension median	286
13.8	Cabinet stability	290
13.8.1	The duration of governments	290
13.8.2	The death of governments	292
13.8.3	Summary	295
13.9	Social stability	295
13.10	Strategic voting	296
13.10.1	Strategic voting under the plurality rule	296
13.10.2	Strategic voting in multiparty systems	297
13.11	Commentary	298
14	The paradox of voting	303
14.1	The rational voter hypothesis	304
14.1.1	Expected utility maximization	304
14.1.2	A taste for voting	306
14.1.3	Voting as a game of cat and mouse	306
14.1.4	The rational voter as minimax-regret strategist	307
14.2	The rational voter hypothesis: the evidence	308
14.3	The expressive voter hypothesis	320
14.4	The ethical voter hypothesis	322
14.5	Ethical preferences as selfish behavior	325
14.6	The selfish voter	326
14.7	Summary and implications	329
15	Rent seeking	333
15.1	The theory of rent seeking	333
15.1.1	The basic rent-seeking model with a fixed number of players	335
15.1.1.1	Diminishing or constant returns, $r \leq 1$	336
15.1.1.2	Increasing returns with $1 < r \leq 2$	336
15.1.1.3	Increasing returns with $r > 2$	337

15.1.2	The impact of free entry	337
15.1.3	Rent seeking with sequential investments	338
15.1.4	Relaxing the assumptions	340
15.1.4.1	Risk-neutrality	340
15.1.4.2	Rent seeking among groups	342
15.1.4.3	Rent seeking when the probability of winning is not defined logistically	342
15.1.4.4	Designing rent-seeking contests	342
15.2	Rent seeking through regulation	343
15.3	Rent seeking and the political process	347
15.4	Rent seeking through tariffs and quotas	348
15.4.1	The economic effects of tariffs, quotas, and voluntary export restraints	348
15.4.2	Endogenous protection models	350
15.4.3	Remaining puzzles	353
15.5	Rent seeking in other governmental activities	354
15.6	How large are the welfare losses from rent seeking?	355
16	Bureaucracy	359
16.1	Uncertainty, information, and power	360
16.2	The budget-maximizing bureaucrat	362
16.2.1	Environment and incentives	362
16.2.2	The model	363
16.3	Extensions of the model	365
16.3.1	Alternative institutional assumptions	365
16.3.2	Bargaining between sponsor and bureau	368
16.4	Alternative behavioral assumptions	368
16.4.1	The slack-maximizing bureaucrat	368
16.4.2	The risk-avoiding bureaucrat	370
16.5	Empirical tests	371
16.5.1	Power of the agenda setter	371
16.5.2	Cost differences between publicly and privately provided services	373
16.6	The government as Leviathan	380
16.6.1	Theory	380
16.6.2	Empirical testing – government expenditures and taxes	382
16.7	Conclusions	384
17	Legislatures and bureaucracies	386
17.1	The Congressional-dominance model	386
17.1.1	Congressional dominance through administrative structure	386
17.1.2	Congressional dominance through administrative procedure	388
17.2	The impact of uncertainty and transaction costs	388
17.2.1	Uncertainty and the locus of responsibility	389
17.2.2	Uncertainty, transaction costs, and commitment	389
17.3	Congress and the president	391
17.3.1	The legislature controls the president	391
17.3.2	Presidential control over the legislature	393
17.3.3	The problem of deadlocks	395

17.4	Congress, the president, and the judiciary	399
17.4.1	Adding the judiciary to the model	399
17.4.2	The goals of the judiciary	399
17.5	Legislative decision making in the European Union	401
17.6	Conclusions	405
18	Dictatorship	406
18.1	The origins of dictatorship	407
18.2	The goals of dictators	409
18.2.1	The consumption of the dictator	409
18.2.2	Power	411
18.2.3	Security	411
18.3	The functioning and survival of dictatorships	412
18.3.1	The utility-maximizing dictator	412
18.3.2	Tin pots and totalitarians	413
18.3.3	Selective strategies to survive	414
18.3.4	The dictator's dilemma	416
18.3.5	The limits of totalitarianism	417
18.4	The rise and decline of dictatorships	417
18.5	Dictatorship and economic performance	420
18.5.1	The relative advantages of dictatorship and democracy	420
18.5.2	The relative economic performance of dictatorships and democracies	422
18.5.2.1	A direct test of Wintrobe's model of dictatorship	424
18.6	Conclusions	424
 Part IV Applications and testing		
19	Political competition and macroeconomic performance	429
19.1	Macroeconomic performance and political success	429
19.1.1	Vote and popularity functions	429
19.1.2	Whom do voters hold responsible?	433
19.2	Opportunistic politics	437
19.2.1	With myopic voters	438
19.2.2	With rational voters	439
19.3	Partisan politics	440
19.3.1	Partisan politics with retrospective voters	443
19.3.2	Partisan politics with rational, forward-looking voters	444
19.4	The evidence	446
19.4.1	Do politicians try to manipulate the macroeconomic environment?	446
19.4.2	Are there partisan biases?	447
19.4.3	Which theories fit the data best?	451
19.4.4	Additional evidence for the Alesina/Rosenthal model	455
19.4.5	Discussion	456
19.5	Voter behavior	459
19.5.1	Myopic, retrospective, rational	459
19.5.2	Sociotropic or egotropic	460
19.6	Politics and inflation	461

19.6.1 Hypotheses	461
19.6.2 The facts	462
19.6.3 Central bank independence	465
19.7 Deficits	466
19.7.1 The facts	466
19.7.2 Hypotheses	466
19.7.2.1 Fiscal illusion and Keynesian delusions	466
19.7.2.2 Political business cycles	467
19.7.2.3 Partisan effects	467
19.7.2.4 Government paralysis	467
19.7.2.5 Budgetary rules	468
19.7.3 The evidence	468
19.8 Reflections	469
20 Interest groups, campaign contributions, and lobbying	472
20.1 The logic of collective action	473
20.2 Models of interest group behavior in politics	475
20.2.1 Informative campaigning in a Downsian model	476
20.2.2 Persuasive campaigning in a Downsian model	477
20.3 Empirical studies of the causes and consequences of campaign contributions	481
20.3.1 Votes for a candidate are a function of campaign expenditures	481
20.3.2 Determinants of campaign contributions	486
20.3.3 Determinants of representative voting behavior – campaign contributions	489
20.3.4 Determinants of representative voting behavior – ideology or pure survival	489
20.3.5 Evaluation	493
20.4 Lobbying	496
20.5 The welfare effects of interest group activities	497
21 The size of government	501
21.1 The facts	501
21.2 Explanations for the size and growth of government	506
21.2.1 The government as provider of public goods and eliminator of externalities	506
21.2.1.1 “Taste variables”	507
21.2.1.2 Income	509
21.2.1.3 The Baumol effect	510
21.2.2 The government as redistributor of income and wealth	511
21.2.2.1 The Meltzer and Richard model	512
21.2.2.2 Additional redistribution–growth-of-government hypotheses	514
21.2.2.3 Some logical/empirical difficulties with the redistribution– growth-of-government hypothesis	515
21.2.2.4 Direct empirical tests of the redistribution–government-size hypothesis	516
21.2.3 Interest groups and the growth of government	519
21.2.4 Bureaucracy and the growth of government	523

21.2.5	Fiscal illusion	527
21.2.6	Tax elasticity	529
21.3	Conclusions	530
22	Government size and economic performance	535
22.1	The welfare losses from taxation	536
22.2	Government size and black market activity	539
22.3	Government size and corruption	544
22.4	Government size and economic productivity	545
22.5	Government size and economic growth	548
22.5.1	Methodological issues	548
22.5.2	The evidence	551
22.6	Government activity and the economic decline of nations	554
22.6.1	The logic	554
22.6.2	Empirical evidence	556
22.7	Conclusions	559
Part V Normative public choice		
23	Social welfare functions	563
23.1	The Bergson-Samuelson social welfare function	563
23.2	Axiomatic social welfare functions	568
23.2.1	Fleming's social welfare function	568
23.2.2	Harsanyi's social welfare function	569
23.2.3	Two criticisms of Harsanyi's social welfare function	571
23.2.3.1	Should individual attitudes toward risk count?	571
23.2.3.2	Can individuals agree on a value for W ?	572
23.2.4	Ng's social welfare function	575
23.2.5	Nash's and other multiplicative social welfare functions	576
23.3	What form of social welfare function is best?	578
24	The impossibility of a social ordering	582
24.1	Logic of the proof	583
24.2	Relaxing the postulates	585
24.2.1	Transitivity	586
24.2.2	Unrestricted domain	589
24.2.3	Independence of irrelevant alternatives	590
24.3	Strategy-proof social welfare functions	592
24.4	Implications for public choice	595
25	A just social contract	597
25.1	The social contract	598
25.2	The two principles of justice	599
25.3	Extensions of the theory to other political stages	602
25.4	Critique of the Rawlsian social contract	603
25.4.1	The social contract	603
25.4.2	The two principles of justice	607
25.4.3	Experimental evidence	609
25.5	Two utilitarian defenses of the maximin principle	609
25.5.1	Maximin as a means to obtain compliance	609
25.5.2	Maximin as a redistribution principle	611
25.6	The social contract as a constitution	612

26	The constitution as a utilitarian contract	615
26.1	The constitutional context	616
26.2	The two-action case	617
26.3	The constitutional contract	619
26.3.1	Optimal collective action with only identity uncertainty	620
26.3.2	Optimal collective action with identity and numbers uncertainty	622
26.3.3	Optimal collective action with identity, numbers, and payoff uncertainty	624
26.4	Symmetric and asymmetric bans and obligations	624
26.5	Continuous actions with interdependent utilities	625
26.6	Decision-making costs	627
26.6.1	Prisoners' dilemmas	628
26.6.2	Direct conflicts	631
26.7	Rights and obligations	631
26.8	Constitutions: contracts or conventions?	634
26.8.1	Constitutions as contracts	634
26.8.2	Constitutions as conventions	636
26.8.3	Discussion	637
26.9	Conclusions regarding two-stage theories of social choice	639
26.10	From the normative, two-stage theory of constitutions to hypothesis testing	640
27	Liberal rights and social choices	643
27.1	The theorem	643
27.2	Resolving the paradox	644
27.2.1	Rights over Pareto	644
27.2.2	Pareto trades of actions	646
27.2.3	Pareto trades of rights	648
27.3	Rights over social states versus rights over actions	650
27.4	Liberal rights and obligations	651
27.5	Constitutional rights and liberal rights	652
	Part VI What have we learned?	
28	Has public choice contributed anything to the study of politics?	657
28.1	The failures of rational actor models of politics	658
28.2	The rational choice approach to modeling	659
28.3	The prediction of cycling	662
28.4	The predictions of spatial models	663
28.5	Predicting voting and free-riding	666
28.6	Can public choice contribute to the positive study of political institutions?	668
28.7	Has public choice contributed anything to the normative study of political institutions?	670
28.8	Conclusions	671
29	Allocation, redistribution, and public choice	675
	<i>References</i>	683
	<i>Name index</i>	749
	<i>Subject index</i>	763

Introduction

Man is by nature a political animal.

Aristotle

This division of labour . . . is the necessary, though very slow and gradual, consequence of a certain propensity in human nature which has in view no such extensive utility; the propensity to truck, barter, and exchange one thing for another.

Whether this propensity be one of those original principles in human nature . . . or whether, as seems more probable, it be the necessary consequence of the faculties of reason and speech, it belongs not to our present subject to enquire. It is common to all men and to be found in no other race of animals, which seem to know neither this nor any other species of contracts.

Adam Smith

Aristotle, observing the Greeks in the fourth century B.C., thought that man's natural proclivities were toward discourse and political activity. Adam Smith, observing the Scots in the eighteenth century A.D., saw instead a propensity to engage in economic exchange. From the observations of these two intellectual giants, two separate fields in the social sciences have developed: the science of politics and the science of economics.

Traditionally, these two fields have been separated by the types of questions they ask, the assumptions they make about individual motivation, and the methodologies they employ. Political science has studied man's behavior in the public arena; economics has studied man in the marketplace. Political science has often assumed that political man pursues the public interest. Economics has assumed that all men pursue their private interests, and has modeled this behavior with a logic unique among the social sciences.

But is this dichotomy valid? Could both Aristotle and Smith have been right? Could political man and economic man be one and the same? In the field of public choice, it is assumed that they are.

Public choice can be defined as the economic study of nonmarket 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, voter behavior, party politics, the bureaucracy, and so on. The methodology of public choice is that of economics, however. The basic behavioral postulate of public choice, as for economics, is that man is an egoistic, rational, utility

maximizer.¹ This places public choice within the stream of political philosophy extending at least from Thomas Hobbes and Benedict Spinoza, and within political science from James Madison and Alexis de Tocqueville. Although there is much that is useful and important in these earlier contributions, and much that anticipates later developments, no effort is made here to relate these earlier works to the modern public choice literature, for they are separated from the modern literature by a second salient characteristic. The modern public choice literature employs the analytic tools of economics. To try to review the older literature using the analytic tools of its descendants would take us too far afield.²

Public choice has developed as a separate field largely since 1948. During the thirties, disenchantment with market processes was widespread, and models of “market socialism” depicting how governments could supplant the price system and allocate goods as efficiently as markets do, if not more so, came into vogue. Abram Bergson’s (1938) seminal analysis of social welfare functions (SWFs) appeared to indicate how the economist’s individualistic, utilitarian ethics could be incorporated into the government planner’s objective function and help him to achieve a social welfare maximum as he managed the state.

Arrow’s 1951 book was a direct follow-up to both Bergson’s (1938) article and Paul Samuelson’s parallel discussion of SWFs in *Foundations of Economic Analysis* (1947, ch. 8). Arrow’s concern was to characterize the process, whether market or political, through which the SWF Bergson and Samuelson had described was achieved (rev. ed. 1963, pp. 1–6). Since Arrow’s book, a large literature has grown up exploring the properties of social welfare or social choice functions.³ It focuses on the problems of aggregating individual preferences to *maximize* an SWF, or to satisfy some set of normative criteria, that is, on the problem of which social state *ought* to be chosen, given the preferences of the individual voters. This research on optimal methods of aggregation naturally has spurred interest in the properties of *actual* procedures for aggregating preferences via voting rules, that is, on the question of which outcome will be chosen for a given set of preferences under different voting rules. The problem of finding a social choice function that satisfies certain

¹ For a detailed justification of this postulate in the study of voting, see Downs (1957, pp. 3–20), Buchanan and Tullock (1962, pp. 17–39), and Riker and Ordeshook (1973, pp. 8–37). Schumpeter’s (1950) early use of the postulate also should be mentioned. One of the curiosities of the public choice literature is the slight *direct* influence that Schumpeter’s work appears to have had. Downs claims that “Schumpeter’s profound analysis of democracy forms the inspiration and foundation for our whole thesis” (1957, p. 27, n. 11), but cites only one page of the book (twice), and this in support of the “economic man” assumption. Most other work in the field makes no reference to Schumpeter at all.

Tullock has made, in correspondence, the following observation on Schumpeter’s influence on his work: “In my case, he undeniably had immense impact on me, although it was rather delayed. Further, although I read the book originally in 1942, I didn’t reexamine it when I wrote *The Politics of Bureaucracy* (1965). In a sense, it gave me a general idea of the type of thing that we could expect in government, but there weren’t any detailed things that could be specifically cited.” I suspect that Schumpeter’s work has had a similar impact on others working in the public choice field.

For an interesting discussion of the public choice content of Schumpeter’s work, see Mitchell (1984a,b).

² See, however, Black (1958, pp. 156–213), Buchanan and Tullock (1962, pp. 307–22), Haefele (1971), Ostrom (1971), Hardin (1997), Mueller (1997b), and Young (1997).

³ For surveys, see Sen (1970a, 1977a,b), Fishburn (1973), Plott (1976), Kelly (1978), Riker (1982b), and Pattanaik (1997).

normative criteria turns out to be quite analogous to establishing an equilibrium under different voting rules. Thus, both Arrow's study (1963) of SWFs and Black's (1948a,b) seminal work on committee voting procedures build on the works of de Borda (1781), de Condorcet (1785), and C.L. Dodgson (Lewis Carroll) (1876). We discuss the most directly relevant topics of the SWF literature as part of normative public choice in Part V.

Part I also contains a normative analysis of collective action. The models of market socialism developed in the thirties and forties envisioned the state as largely an allocator of private goods. State intervention was needed to avoid the inefficient shortfalls in private investment, which Keynesian economics claimed were the cause of unemployment, and to avoid the distributional inequities created by the market. The immediate prosperity of the post-World War II years reduced the concern about unemployment and distributional issues. But concern about the efficiency of the market remained high among academic economists. The seminal works of the forties and fifties gave rise to a large literature on the conditions for efficient allocation in the presence of public goods, externalities, and economies of scale. When these conditions were unmet, the market failed to achieve a Pareto-optimal allocation of goods and resources. The existence of these forms of market failures provides a natural explanation for why government ought to exist, and thus for a theory of the origins of the state. It forms the starting point of our analysis of the state and is reviewed in Chapter 2. Chapter 3 takes up models of collective action that see redistribution as its main objective. Together these two activities – improving allocative efficiency and redistribution – constitute the only possible *normative* justifications for collective action.

If the state exists in part as a sort of analogue to the market to provide public goods and eliminate externalities, then it must accomplish the same preference revelation task for these public goods as the market achieves for private goods. The public choice approach to nonmarket decision making has been (1) to make the same behavioral assumptions as general economics (rational, utilitarian individuals), (2) often to depict the preference revelation process as analogous to the market (voters engage in exchange, individuals reveal their demand schedules via voting, citizens exit and enter clubs), and (3) to ask the same questions as traditional price theory (Do equilibria exist? Are they stable? Pareto efficient? How are they obtained?).

One part of the public choice literature studies nonmarket decision making, voting, as if it took place in a direct democracy. The government is treated as a black box or voting rule into which individual preferences (votes) are placed and out of which collective choices emerge. This segment of the literature is reviewed in Part II. Chapter 4 examines criteria for choosing a voting rule when the collective choice is restricted to a potential improvement in allocative efficiency. Chapters 5 and 6 explore the properties of the most popular voting rule, the simple majority rule. Chapters 7 and 8 present a variety of alternatives to the majority rule – some equally simple, others more complex. Part II closes with a discussion of how individuals can reveal their preferences for public goods not through the voice mechanism of voting, but by choosing to join different polities or public good clubs (Chapter 9).

Just as Arrow's book was stimulated in part by Bergson's essay, Downs's 1957 classic was obviously stimulated by the works of both Bergson and Arrow (pp. 17–19). To some extent, Downs sought to fill the void Arrow's impossibility theorem had left by demonstrating that competition among parties to win votes could have the same desirable effects on the outcomes of the political process as competition among firms for customers has on the outcomes of the market process. Of all the works in public choice, Downs's book has had perhaps the greatest influence on political scientists.

In the Downsian model, the government appears not merely as a voting rule or black box into which information on voter preferences is fed, but as an institution made up of real people – representatives, bureaucrats, as well as voters – each with their own set of objectives and constraints. The Downsian perspective on government underlies Parts III and IV of this book. Part III begins with a discussion of the implications of having multiple levels of government as in a federalist system. Chapters 11 and 12 examine the properties of two-party representative democracies. Although Chapter 11 reveals that Downs's original formulation of a model of two-party competition did not succeed in resolving the "Arrow paradox" of aggregating individual preferences to maximize an SWF, Chapter 12 discusses more recent models of two-party competition that do appear to achieve this goal.

All of the "founding fathers" of the public choice field were either American or British. Not surprisingly, therefore, most of the early literature in the field focused on two-party systems. In the last two decades, however, the study of multiparty systems by public choice analysts has expanded greatly. This work is reviewed in Chapter 13.

Although Downs's goal was to resolve the Arrow paradox, ironically one of the most important contributions of his book was to put forward a paradox of its own – namely, the paradox of why rational, self-interested people bother to vote at all. Downs's original model of the rational voter and the many extensions and modifications to it that have been made form the subject matter of Chapter 14.

The redistributive potential of representative government – which is generally treated under the heading of "rent seeking" – is the subject matter of Chapter 15. Part III closes with three chapters that review several theories of the state in which the state itself – in the form of the bureaucracy, the legislature, or an autocratic leadership – dictates outcomes with the citizenry relegated to playing a more passive role.

In arguing that government intervention is needed to correct the failures of the market when public goods, externalities, and other sorts of impure private goods are present, the economics literature has often made the implicit assumptions that these failures could be corrected at zero cost. The government is seen as an omniscient and benevolent institution dictating taxes, subsidies, and quantities so as to achieve a Pareto-optimal allocation of resources. In the sixties, a large segment of the public choice literature began to challenge this "nirvana model" of government. This literature examines not how governments may or ought to behave, but how they do behave. It reveals that governments, too, can fail in certain ways. This largely empirical literature on how governments do perform is reviewed in Chapters 19 through 22.

One of the major justifications for an increasing role for government in the economy during the first couple of decades following World War II was the Keynesian prescription that government policies are required to stabilize and improve the macroeconomic performance of a country. The evidence that governments' macroeconomic policies are affected by their efforts to win votes is examined in Chapter 19, which also looks at the impact of electoral politics on macroeconomic performance.

One of the early classics in the public choice literature is Olson's (1965) *The Logic of Collective Action*. In this book Olson applied public choice reasoning to the analysis of various collective action problems involving interest groups. Interest groups have been a focal point within the public choice literature ever since. Although their activities are discussed at several junctures in the book, Chapter 20 is devoted exclusively to the literature that models and measures the impact of interest groups on political outcomes.

One of the most remarkable developments over the half century following World War II has been the growth in size of governments around the world. Is this growth a response to the demands of citizens for greater government services because of rising incomes, changes in the relative price of government services, or a change in "tastes"? Does it reflect the successful efforts of some groups to redistribute wealth from others by means of the government? Or is it an unwanted burden placed on the backs of citizens by a powerful government bureaucracy? These and other explanations for the growth of government are discussed in Chapter 21.

Where Chapter 21 treats the size of government as the dependent variable in political/economic models of the state, Chapter 22 treats it as an explanatory variable. It reviews the literature that has tried to measure the impact of the growth of the government sector in the industrial democracies of the world on various measures of economic performance, like the growth of income per capita and the distribution of income in each country.

The Bergson-Samuelson SWF, which helped spark interest in preference aggregation procedures, is discussed along with other derivations of an SWF in Chapter 23. The Arrowian SWF literature is reviewed in Chapter 24. Although both of these approaches build their aggregate welfare indexes on individual preferences, both tend to shift attention from the preferences of the individual to the aggregate. Moreover, in both cases, the aggregate (society) is expected to behave like a rational individual, in the one case by maximizing an objective function, and in the other by ordering social outcomes as a rational individual would do. Therefore, the SWF literature bears more than a passing resemblance to organic views of the state in which the state has a persona of its own.

Buchanan's first article (1949) appearing before Arrow's essay was an attack upon this organic view of the state; Buchanan (1954a) renewed this attack following the publication of Arrow's book. In place of the analogy between the state and a person, Buchanan offered the analogy between the state and a market. He suggested that one think of the state as an institution through which individuals interact for their mutual benefit – that one think of government, as Wicksell (1896) did, as a *quid pro quo* process of exchange among citizens (Buchanan, 1986, pp. 19–27). The view of government as an institution for reaching agreements that benefit all citizens leads

naturally to the perspective that the agreements are *contracts* binding all individuals. The contractarian approach to public choice is developed in Buchanan and Tullock's *The Calculus of Consent* (1962) and Buchanan's *The Limits of Liberty* (1975a). The approach taken in the former work also has a strong affinity to Rawls's (1971) influential contribution to the contractarian theory. Chapter 25 takes up Rawls's theory, while Chapter 26 reviews and integrates the models of collective choice which – following Buchanan and Tullock – have viewed politics as a two-stage process in which the “rules of the political game” are written in the first stage and the game is played in the second stage.

One indication of the significance of public/social choice's intellectual impact is the fact that three of the major figures in this field have been awarded Nobel prizes – Kenneth Arrow, James Buchanan, and Amartya Sen.⁴ Although Sen's contributions to social choice go far beyond the topic of “the liberal paradox,” this contribution of his has stimulated such a vast amount of work that it warrants separate treatment, which it gets in Chapter 27.

Although most of this book focuses on the accomplishments of public choice in extending our positive and normative understanding of politics, some criticisms that have been leveled against the public choice approach to politics are taken up in Chapter 28. A reader who is skeptical about whether rational actor models can offer anything to the study of politics might wish to glance ahead at Chapter 28 before plunging into the next 26 chapters. But I do not think that the reader can obtain a full appreciation for the advantages – and limitations – of the public choice approach without submerging him- or herself into its subject matter.⁵ Thus, my recommendation is to save Chapter 28 and the critiques of public choice until after the reader has absorbed its lessons.

One of Wicksell's important insights concerning collective action was that a fundamental distinction exists between allocative efficiency and redistribution and that these two issues must be treated separately, with separate voting rules.⁶ This insight reappears in Buchanan's work in which the constitutional and legislative or parliamentary stages of government are separated, and in Musgrave's *The Theory of Public Finance* (1959) in which the work of government is divided into allocative and redistributive branches. The distinction is also featured in this book and constitutes the theme of its closing chapter.

⁴ One might arguably claim that *four* economists working in the field have won Nobel prizes, since William Vickrey's prize was awarded for his research on incentive systems, which anticipated the development of the family of “demand-revealing” voting mechanisms reviewed in Chapter 8.

⁵ Rather than continually write “his or her,” I shall sometimes make voters (politicians, bureaucrats, dictators, and so forth) men and sometimes women. I have tried to treat the two sexes evenhandedly in this regard.

⁶ Wicksell's 1896 essay is part of the contribution of the “continental” writers on public economics. Besides Wicksell's work, the most important papers in this group are those of Lindahl (1919). Of the two, Lindahl has had greater influence on public goods theory, and Wicksell on public choice and public finance. Their works, along with the other major contributions of the continental writers, are in Musgrave and Peacock (1967).