

**THE ROLE OF PUBLIC CHOICE
CONSIDERATIONS
IN NORMATIVE PUBLIC ECONOMICS**

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INTRODUCTION AND OVERVIEW

The topic of this session is a daunting one—to contemplate to what extent public choice or political economy considerations ought to be taken into account in normative public economic analysis. In particular, should the prescriptions obtained from normative analysis be constrained by considerations of political feasibility? The issue is of fundamental importance for the formulation and execution of economic policy, which is necessarily a prescriptive exercise with normative content. To put my cards on the table at the outset, my view is that, with some exceptions, political feasibility considerations should generally not constrain policy analysis and advice, at least by non-partisan economists. My purpose is to explain, if not to convince, readers why I hold that view. I hope that at least readers will find the position to be provocative and one that stimulates debate even if it is not found to be persuasive.

The term 'normative approach' is a very general one and can be used for many purposes. It is useful to distinguish two broad ones at the outset. Normative analysis can be used for *evaluative* or for *prescriptive* purposes. In the former case, one is evaluating the normative properties of actual or potential outcomes, outcomes that may well be the consequence of collective choice processes. In the second case, one is actually prescribing or recommending courses of action as an input to collective choice process. This paper is primarily directed to the prescriptive use of normative public economic

analysis. It is in this case that the role of political economy constraints is the most relevant. Of course, the normative content of public economic analysis is basically the same whether the purpose is evaluative or prescriptive. Thus, much of our discussion will apply to either. But, it seems inherently less controversial to ignore political economy considerations in evaluating outcomes than in prescribing policy. What might be controversial is the evaluative exercise itself. There are economists who completely eschew normative analysis, and who view the scientific role of economics to be purely positive. This is in fact a difficult position to maintain in practice, since it would imply that even seemingly innocuous statements about the benefits of free markets could not be advocated. Thus, we take it as given at the outset that normative analysis has a legitimate, and indeed necessary, role to play in the economic policy process. The issue is whether and how political feasibility should play a part.

The paper proceeds as follows. To put matters in context, it is useful to begin with an overview of the key ingredients and methodology of the normative approach. In fact, they are not as far from the concerns of public choice as is sometimes depicted. Next, we summarize some problems facing the normative approach. Then we turn to the question of what and when public choice considerations ought to condition normative analysis. This will involve both matters of principle—why in principle public choice considerations should not be treated as a constraint on normative analysis—and matters of practicality—why public choice considerations are not in a position to be used as constraints. The latter involves essentially a brief critique of public choice or political economy as it has developed to date.

It should be stressed at the outset that, although this paper is focused mainly on the normative approach, nothing in it should be taken to suggest that the normative approach has a monopoly on being the correct one. Normative and positive approaches to collective decision-making and the analysis of economic policy issues are complementary. Neither one rules out, or is more legitimate, than the other. The only concern is with defending at least one approach to normative analysis, one that explicitly ignores political feasibility constraints in prescriptive analysis. This involves thinking about when and how the descriptive should influence the prescriptive. Indeed, the issue

could fruitfully be put the other way as well: when and how should normative principles be used to judge positive outcomes?

PRINCIPLES OF NORMATIVE PUBLIC ECONOMICS

The ultimate purpose of much normative public sector analysis is prescriptive: what are good policies or good reforms? Normative analysis can serve a policy evaluation purpose and an advisory purpose, and can have a real impact on actual collective decision-making. It is therefore important to be clear about what it involves.

There are three ingredients that go into normative analysis. The first is a presumption about *how a decentralized market economy functions*, and its formalization in demand and supply functions, profit functions, and indirect utility functions. This ingredient is essentially a positive one, at least insofar as indirect utility functions simply reflect revealed preference and not social weights. Impediments to the functioning of markets may be important, such as monopoly, unions, free riding, and market imperfections due to uncertainty and information, and coordination failures. Moreover, non-rational behaviour may be relevant. But, in general, there seems to be broad consensus in the profession about how markets operate and when they fail, although refinements are continually being discovered, as exemplified in the enormous literature on the so-called New Institutional Economics recently surveyed in the *Journal of Economics Literature* by Oliver Williamson. This might be contrasted with the case of political markets, where much less consensus exists with respect to their functioning. This may simply reflect the earlier stage of development of their study.

The second ingredient used in normative analysis is the set of *constraints* facing the analyst. These can be classified into three types. The first are the constraints imposed by the availability of existing *technology*. These will already be reflected in the excess demand functions mentioned above that describe the functioning of the market economy. The second type of constraint involves *resource balance*. These are captured in the market clearing conditions that apply in equilibrium, taking due account of any endogeneity of resource supplies over time. The third type of constraint involves *information*. As mentioned, there may be imperfect information in the private sector, which will be reflected in market outcomes. But, the government may be ill informed in

many ways as well, and this can impede the range of policy prescriptions that can be implemented. They have imperfect information about household preferences (and thus market responses) especially where these vary across households, about household abilities, about non-market activities, and about the extent of illegal or underground behaviour. These are important constraints on policy prescription, and can lead to quite different ones than in a first-best world of full information. Thus, the set of feasible points along the economy's relevant utility possibilities frontier (UPF) can differ considerably among the first best, the second best when only incomes are observable, and the third best when even incomes can be misreported to evade taxes. Indeed, much modern normative public economics is driven by characterizing second-best or nth-best policies in a world constrained by imperfect information of various sorts, and as an extension, to searching for ways to reduce informational constraints by monitoring, penalizing illegal behaviour, and so on. Our purpose in this paper is to consider whether political economy constraints should play a similar role to informational constraints: Should policy advice be constrained to be politically feasible as well as informationally feasible?

Third, and most controversially, normative analysis and policy prescription requires *objectives*, and these *necessarily* involve at least minimal value judgments. Some value judgments commonly used in prescriptive analysis are relatively non-controversial for standard purposes (and many even creep into the public choice literature). Examples include those that underlie conventional social welfare functions (SWFs): a) individualism (that household preferences ought to be respected), b) anonymity (that all households be given equal weight in the objective function regardless of their identification), c) symmetry (that the SWF be symmetric in utilities), d) the Pareto principle (that the SWF be increasing in individual utilities). Taken together, these result in the notion of *welfarism*, which forms the basis for Bergson-Samuelson SWFs. These value judgments alone are sufficient for giving normative significance to economically efficient outcomes (points along the UPF), and some useful prescriptive properties of policies require only that. For example, the so-called 'production efficiency theorem' of Diamond and Mirrlees relies only on them, as do shadow prices for project evaluation in a small open economy.

However, in general, we cannot get very far with policy prescriptions that are based on efficiency alone, especially in a second-best world where the Second Theorem of Welfare Economics fails. That is, we simply cannot separate efficiency from equity considerations, and pursue the Musgravian strategy of providing advice on efficient policies so as to get to the UPF, while leaving it to some other unspecified process for choosing the appropriate point along the UPF. More important, many policies are explicitly redistributive in nature, to an extent that we economists are not always willing to acknowledge. In fact, it can be argued that governments are not primarily involved in exploiting gains from trade arising from free riding and market failure. Instead, like it or not, government is primarily an institution for redistribution. This redistribution occurs in many dimensions, including through equalizing outcomes, equalizing opportunities, and providing social insurance. For prescriptive purpose, we need a means of evaluating these policies, and that inevitably involves making interpersonal welfare comparisons, if only implicitly.

Interpersonal Welfare Comparisons

More generally, as the welfare economics literature has made clear, interpersonal comparisons are mandatory for policy prescriptions of all sorts, not just those with explicit redistributive intent. In a second-best setting, all policies—even those with efficiency objectives—have gainers and losers, and it is impossible to avoid taking account of that somehow. There have been many attempts to get around that problem and to focus on the efficiency effects of policies to avoid interpersonal comparisons of welfare, but all have been bound to fail. Appealing to the various compensation tests, such as those proposed by Kaldor, Hicks, Scitovsky or Samuelson does not work, even if one accepts the demanding value judgment involved in the hypothetical compensation principle. Adopting the Harberger dictum that ‘a dollar is a dollar’—or a ‘euro is a euro’—implies a rather peculiar implicit SWF that is additive and linear in money metric utility, which is unlikely to generate much ethical consensus. The more appealing Musgrave approach of leaving redistribution to the so-called Distributive Branch of government fails demonstrably in a second-best world, essentially because the failure of the Second Theorem means the Distributive Branch cannot do its job. In effect, the

Distribution and Allocation functions of government are inextricably intertwined. Thus, explicit interpersonal comparisons are necessary, and public choice is not likely to be particularly helpful in avoiding that. Indeed, part of what normative economists do is to inform the political process with respect to interpersonal welfare judgments and their consequences for policy.

The argument that interpersonal comparisons of welfare cannot in principle be avoided is a rather important one, and one that we often honour in the breach. Major policy prescriptions like free trade, tax reform, competition policy, unemployment insurance, and so on, are typically proposed by economists on the basis of efficiency arguments. As a matter of principle, such advice is potentially incomplete if it does not take account of the redistributive impacts that these policies necessarily have. That is not to say that as a matter of expediency those in government ought to use distributive weights as a matter of course. But those of us in the academic business of normative policy prescription and evaluation cannot assume that the concept of efficiency is a sufficient concept for normative analysis. Put another way, in a second-best world, given the failures of the First and Second Best Theorems of Welfare Economics, market prices do not have the normative content that is often attributed to them. They do not reflect shadow values as in a first-best world.

In fact, the sort of interpersonal judgments that are involved in standard normative analysis are often not that controversial, and might enjoy a fair amount of consensus. At least, they do among practitioners of normative analysis. In the context of welfaristic objectives (of which, more will be said below), many of the most important qualitative policy prescriptions found in the normative literature—those emanating from the optimal income tax literature—require only a non-negative aversion to inequality. This assumption alone, which one expects would command fairly widespread support, narrows down the range of outcomes on the second-best UPF considerably: all those between the utilitarian outcome and the Rawlsian outcome would be included. Although this seems like a wide range, the qualitative features of the solutions are quite similar, and distinct from those in the other range of the second-best UPF. Moreover, the degree of aversion to inequality can be readily parameterized, and policy proposals can be posed in such a

way that allows decision-makers to see the implications of different degrees of aversion to inequality.

PROBLEMS FOR NORMATIVE PUBLIC ECONOMICS

Normative analysis, like positive analysis and public choice, is obviously constantly developing. It is in a constant process of evolution as new problems come to light, and new interpretations are found. Let me highlight what at this stage of development seem to me to be some of the main conceptual problems facing normative public economics.

The Need For Value Judgments

As mentioned, prescriptive analysis cannot be done without value judgment. As mentioned, almost all policy evaluation requires interpersonal welfare comparisons implicitly or explicitly. There is no natural or scientific way to choose among value judgments, and we know from public choice theory that societal consensus will almost certainly be difficult to achieve. Progress will be made into ways of formulating interpersonal welfare comparisons, developing new insights from them, and studying their implications for policy. Indeed, that is one dimension of normative policy analysis. It is apparent that the analyst must choose his/her own value judgments, presumably reasonable ones, make them explicit, argue for them, and be accountable for them. In the end, the decision-maker must have a normative basis for choosing among options.

Non-Welfaristic Objectives

Normative public economics continually strives to clarify value judgments and discover new ones. In recent years, there has been growing emphasis on non-welfaristic objectives. These include notions such as equality of opportunity and capability, fairness, poverty alleviation. This poses challenges in its own right not just in the value judgment associated with the objective itself and the fact that a different dimension of interpersonal comparisons are necessary, but also because welfaristic and non-welfaristic objectives are typically in conflict as the social choice literature has convincingly shown. Resolving this conflict itself involves a value judgment. Nonetheless, such conflicts among

objectives must be resolved: it is not enough for policy purposes to simply show the impossibility of satisfying two conflicting objectives, as is often the focus in the social choice literature. Normative analysts are in a good position both to pose the ethical issues involved, and to suggest ways to the political process of resolving them. What should be noted is the role that normative analysis plays vis-~~B~~-vis the political process. It poses, discovers and clarifies objectives as well as ways of achieving them and in so doing informs collective decision-making.

Differences In Preferences

If the economy consists of households who have identical preferences (as in the standard optimal income tax world), non-negative aversion to inequality provides a natural and reasonably acceptable interpersonal value judgment to adopt. However, if preferences differ, things are much more difficult. There is no natural way to compare persons with, say, different tastes for leisure. Nor is it clear what political economy can contribute to that. Different parts of the literature have adopted different assumptions. For example, some economists hold that differences in preferences should not count in policy analysis, and households should be compensated only for differences in their ability to generate incomes. Others hold that the decision-maker must explicitly compare the welfare of those with high and low tastes for leisure, even if they have the same income-earning ability. But perhaps the greatest contribution of the literature is to analyze systematically the ethical issues involved and the consequences of adopting alternative ethical stances. Adopting a particular ethical perspective in one's research is necessary, given that some value judgment must be made in order to offer policy prescriptions. Given that, it is obviously important to be forthright about one's ethical choices.

Irrational Behaviour

Various forms of 'irrational behaviour' emphasized recently in the behavioural economics literature pose an even greater challenge for normative economics. Examples include addiction, myopia, hyperbolic discounting, misjudging odds, and simply irrational decision-making because of mental illness or age. Addressing these issues

would seem to challenge the fundamental norm of individuality by having the state adopt paternalistic policies.

Inter-Generational Issues

Taking account of the interests of future generations is also a challenge, quite apart from the fact that the future is unpredictable. There is presumably a tendency for political processes (as well as many economic analyses) to put relatively high weight on the utility of the current generations (including their altruistic urges). The normative analyst would feel free to adopt alternative ethical principles with respect to the well being of future generations.

Time Inconsistency

One of the biggest challenges to normative welfare economics comes from the fact that in a second-best inter-temporal setting, second-best policies of well-intentioned, benevolent and 'rational' governments can be time inconsistent. Unless governments are somehow able to commit to pre-announced second-best optimal policies, the best they can do is to implement time-consistent ones, which are necessarily welfare-inferior to second-best ones. The consequences of this can be devastating for the quality of outcomes. For example, in some circumstances, well-meaning time-consistent government intervention can actually be Pareto inferior to the *laissez faire*. Taking time inconsistency into account leads to some reasonably strong prescriptive advice. For example, mandatory pensions, investment and savings subsidies, education policies, and various forms of social insurance can have as part of their rationale the undoing of the consequences of time-consistent government policies. It seems clear that this type of constraint is one that normative analysts should—and do—take into account.

Does this amount to accepting political economy considerations as a constraint? After all, time inconsistency is a result of governmental political choice that renders second-best optimal policies infeasible. Although it is partly a matter of semantics, I would argue that time-inconsistency considerations do not represent public choice constraints in the usual sense of ruling out options that are not politically feasible. The

genesis of time-inconsistency is the timing of the implementation of decisions and the inability of governments to commit in advance. The problem applies even when governments are fully benevolent and rational, and do not rule out any option, including second-best policies.

However, the constraint imposed by time-inconsistent government behaviour provides us with a natural lead-in to the main concern of this session, and that is: when should normative public economics take account of public choice considerations?

POLITICAL FEASIBILITY AS A CONSTRAINT ON NORMATIVE ANALYSIS?

Political economy analysis is very much the fashion nowadays. It might seem natural to many economists that political feasibility should play an important role in normative policy analysis. After all, if optimal policies are not feasible, what is the point of recommending them? Moreover, recommendations that do not pass the political feasibility test run the risk of being discounted, and not being taken seriously. It seems clear that such reasoning does colour much policy advice. I can certainly think of many instances in my own country when political feasibility has been allowed to overrule what could be considered on normative grounds good policy advice. Examples that come to mind are the reform of business taxes (where proponents have strived to ensure that the number of losers is minimized), reforming health care (where it is taken as a matter of faith that any attempt to introduce pricing into the system will cause the edifice of public health insurance to fall down), or targeting of universal social programs (where it is assumed that the middle classes will not agree to lose their entitlements). Reinforcing this is the fact that there have been instances in the past where good policy advice was simply not acted on by the political system (proposals for a guaranteed annual income, or for introducing some actuarial principles into unemployment insurance). At the same time, there have been some instances in which good policy advice persuaded governments to undertake reforms that many might have considered to be politically infeasible. A good example of this is free trade, which, until a high-profile advisory commission advocated it, was considered to be politically impossible. Another example was the introduction of a federal value-added tax, despite its political unpopularity. Thus,

from a purely empirical point of view, it does not seem clear that political feasibility is anywhere near a binding constraint. (It should be acknowledged that the political party that introduced both free trade and the value-added tax was summarily dismissed from office shortly thereafter, and lost virtually all their seats.) In some instances, the political feasibility argument may be used as the scapegoat for choices being driven by decision-makers' preferences.

Be that as it may, the position I would like to argue is that, in general, political feasibility should not be taken into account in pursuing normative prescriptive policy analysis. Let me begin by recounting the two main reasons for holding that position—one a matter of pure principle and the other of practicality—and then discuss some exceptions to the rule.

Prescriptive Analysis Informs Public Choice, Not Vice Versa

The first reason for ignoring political feasibility constraints in normative public economics is based simply on the notion that the ultimate purpose of normative analysis is to inform the policy process in its task of choosing among options, and perhaps to persuade it of a preferred alternative. As a matter of principle, it seems inconsistent to rule out on *a priori* grounds options that are normatively superior simply on the basis of a perception that the policy process itself will choose not to adopt them. That seems incompatible with the notion of an economist as a professional social scientist.

To put the matter slightly differently, political feasibility constraints are qualitatively different from technology, resource and information constraints. Political feasibility does not reflect a set of circumstances that are deterministic or exogenous to the decision-maker, but rather the consequences of the choice process itself, albeit a political choice process. The purpose of normative analysis is itself to assist in the taking of collective decisions, to persuade and inform policy-makers, and to bring expert analysis to bear to clarify the ethical nature of the choices to be made, not to obfuscate them.

This point of view may seem radical since it contravenes the positivist strain of thinking that has been particularly prevalent in the Anglo-Saxon economic tradition. This strain holds that economics is analogous to a science, and that as such all

propositions must be empirically verifiable. Unfortunately, a purely positive approach to economics is untenable from a policy point of view. As we stressed earlier, prescriptive policy advice—which is the *raison d'être* of normative public economics—cannot be purely positive. It necessarily involves some value judgments, including especially interpersonal comparisons of well-being. That is not to say that prescriptive analysis is not scientifically valid. On the contrary, it is entirely syllogistic in its nature. And, it is based on the same kind of analysis of private markets that is used in purely positive analysis.

I would further argue, somewhat more controversially, that to constrain prescriptive analysis by what is politically feasible is to bias it in favour of existing stakeholders (i.e. property owners), and to make it more politically conservative than is necessary on ethical grounds. Existing property owners are, after all, the ones with the money, and therefore often the ones with the political power. It can be argued that this consequence of the positivist tradition, along with an ethical presumption in favour of the inviolability of property rights, has influenced public choice theory heavily. The result has been a serious philosophical rift between normative public economics and public choice, a rift that is fairly clearly reflected in the literature and no doubt motivates the need for symposia such as these.

As evidence for this, one need look no further than Buchanan and Tullock's 1962 classic *Calculus of Consent*, which I think we can all agree has been extremely influential. The core viewpoint of this book is that collective choice exists primarily to exploit the gains from trade that remain unexploited because of the free-rider problem. The possibility of inter-personal redistribution is treated a potential 'cost' of the political process rather than a social end in its own right. The ideal social choice procedure would be unanimity—which is as conservative as it gets—but transaction costs unfortunately preclude that. The optimal size of majority needed to take collective decisions is said to reflect the trade-off between these transactions costs and the costs associated with redistribution (i.e. the fact that one may end up more or less arbitrarily on the wrong side of redistribution decisions).

This thinly veiled apology for the ultimate primacy of existing property rights is itself necessarily incomplete as an ethical norm against which to judge collective choice.

For one thing, the market value of property rights (i.e. prices) has no compelling ethical meaning: the wage one receives for one's labour is determined solely by the relevant excess demand function for the particular society one happens to find themselves in, not by any higher ethical evaluation. For another, there is no basis for determining how to share the presumably sizeable gains that are achieved by collective action, and even a perfectly functioning unanimous voting procedure **B** la Wicksell would be unable to prescribe one.

Finally, even from a positivist point of view, the Buchanan-Tullock approach to collective decision-making is far from persuasive. It belies the fact that most of what government does is redistributive in nature and intent, so much so that the redistributive element seems to dominate the gains from trade element. Perhaps this strain of public choice analysis is not positivistic at all. A better, though perhaps unfair, interpretation is that it is every bit as normative as conventional normative public economics. Its intention is to persuade us of its own ethical position, which is that the sanctity of property rights is the ultimate ethical principle that should guide public policy, as vague as that principle might be.

In fact, it can be argued somewhat provocatively that public choice practitioners in the Buchanan-Tullock tradition do not feel constrained to take political feasibility into account in their analyses. Nor do those conventional economic policy analysts who treat 'a euro as a euro' in the fictitious pursuit of efficient economic policies. There seems to be no compelling argument therefore to require normative public economics to take political feasibility into account, except perhaps as a hidden way of given extra weight to the most powerful stakeholders in the political system, that is, those with the property rights to protect.

What Political Feasibility Constraint?

The second argument for ignoring political feasibility constraints is a more practical one. We know too little about political processes to be able to constrain prescriptive analysis by what is feasible, especially since prescriptive analysis is itself intended to persuade and influence policy-makers. There is a reasonable amount of consensus on the other constraints used in normative public economics, conceptually if not in detail. Economists

agree with the general way in which markets operate, and with the resource constraints that policy-makers face. Even here, though, our knowledge of the actual responsiveness of markets to exogenous changes in prices, incomes and policies is quite sparse. As well, informational constraints are reasonably well understood, although the literature is in a constant state of evolution. The kinds of information constraints being applied are being refined regularly. This in itself is a problem for normative public economic analysis since the policy prescriptions can differ considerably under different assumptions about the government's information. That alone should make us cautious about the prescriptions that we advocate, but it should also make the process of research itself very worthwhile and rewarding.

Political constraints are, however, inherently more impractical than technological, resource and information constraints. Some of the reasons are as follows.

Complexity and Unpredictability

Outcomes of political processes are inherently complicated and unpredictable. They are the outcomes of many levels of decision-making most of which are not subject to the same kind of discipline as the profit motive in the private sector. Intangibles like leadership, the power of persuasion and the charisma of certain personalities can affect the outcome. There are certainly lots of examples of changes in policy regimes that would have been very hard to predict. Had economists restricted their policy advice to those policies that were deemed to be politically feasible, they may well have ruled out superior options that might have been accepted, and have skewed others in order to make them politically palatable. It seems to me that given the complexity of political processes, it is not clear that any manageable political economy model can capture the intricacies and nuances of real-world political decision-making.

Given this, it is not surprising that there is scarcely any literature that attempts to incorporate political constraints in any meaningful way into prescriptive analysis. Those contributions that do take political feasibility into account tend to use very simple public choice mechanisms, such as median voter models or Leviathan models. Interestingly, the most common examples of the use of political constraints involve their role in determining constitutional or political decision-making arrangements themselves. Thus,

political economy considerations are sometimes used as an argument for decentralizing government decision-making or imposing constitutional constraints on government discretion. We return to this important issue below.

It might be objected that market processes are complicated as well, yet we accept them as constraints on public decision-making. However, there is a fundamental difference between market processes and political ones that make the use of market constraints much easier to apply. Although market processes involve the interaction of the decisions of millions of private decision-makers, market mechanisms serve as a coordinating device that allows us to characterize the outcomes in prices and excess demand functions. At least as a first approximation, this allows us to take into account the constraints imposed by markets in a reasonably satisfactory way, at least conceptually. No such decentralization result applies to political processes, even though we might adopt market terminology to the political marketplace

Determinism and Rationality

A further, related reason why political economy models are not suitable as constraints for prescriptive analysis is that they are typically deterministic and based on highly informed voters and political decision-makers. Once the objectives of political decision-makers are specified (e.g. vote maximization), and the technology for turning policies into outcomes postulated, simple game theory takes over and determines an outcome (assuming it is unique). One party or candidate is destined to win, and policies are fully specified. It seems there is no room for prescriptive choice and no room for political expertise or advice (such as an economist might give). These features of political models, which are a consequence of treating the political process as a form of political market analogous to an economic market, have the virtue of simplicity. However, it is not clear that they are realistic.

In models of the market economy, we might get away with assuming a high degree of rationality by decentralized decision-makers because of the information that market prices conveys. In public choice models, no such information-economizing device exists. The complexity of virtually all policy instruments makes outcomes inherently uncertain, and ensures that some citizens—the experts—are better informed

than others. Political party platforms and ideologies are typically posed in terms of general policies or principles. Actual policies are the outcome of much more detailed analysis and advice, some of which comes from normative public economic analysis itself.

A further problem related to the deterministic nature of public choice equilibria is that outcomes in these public choice models are not only efficient (as in many models of party competition), but the allocations they choose on the UPF are simply dictated by the political mechanism. Far from acting as a constraint on normative analysis, the process dictates the outcome! There is no room whatsoever for prescription, which seems to me to be hardly a stylized feature that we want to use to characterize political economy models. It is not at all clear how to get out of this box of the political feasibility constraint wagging the prescriptive dog. Dropping the political feasibility constraint is one sure way to do so.

Cycling/Instability

There is a further modeling difficulty that is endemic to virtually all public choice/political economy models, and that concerns the dictates imposed by the Arrow Impossibility Theorem. Even if one accepts the rationality, determinism, and predictability features of these models, they fail to get around the problems of cycling and instability that constitute the most fundamental problem of collective decision-making in democratic societies. This is particularly relevant given our observation that much of what governments do in the economic policy sphere is redistributive in nature.

To make the argument more concrete, consider the two main models currently used as models of public choice—party competition models and citizen candidate models.

Party Competition Models

These models draw on the insight of Downs that political parties exist to trade off the conflicting interests of the citizens, and many of the characterizing features of these models can indeed be found in Downs' definitive (1958) study *An Economic Theory of Democracy*. In Downs, political parties were decision-makers whose objective was to

maximize votes. More recent models, such as those by Dixit and Londregan, have made the objective function of parties somewhat richer by allowing for an ideological component. In these models, there are two closely related ways in which a unique deterministic interior solution is obtained. In one version—the probabilistic voting variant—there is uncertainty about how voters will respond to policies because of some uncertainty inherent in voters' preferences. In the other version—the ideological attachment variant—voters of any observable class (e.g. income class) are distributed according to their exogenous ideological preferences for one party over the other. In either case, political parties cannot target policies (e.g. transfers) to individuals perfectly.

These models essentially avoid cycling by assumption. The assumed extent of uncertainty of voter responses or of the distribution of ideological preferences implies that the function relating expected votes to policies is strictly concave. For example, a party can always attract a few more votes from one group by increasing its transfer to them at the expense of losing a few votes to another group by reducing its transfer to them. The optimal policy is one that ensures that at the margin for all income groups, the incremental benefit in terms of votes from the last euro transferred is the same. Given that voting functions for all groups are concave, there will be a unique vote-maximizing platform for each party given the platform of the other party. This, in turn implies that there will be a unique Nash equilibrium in party platforms.

The problem with this model, as Dan Usher has shown by example in a recent article in the *Canadian Journal of Economics*, is that voting functions are not likely to be concave in a world in which governments are engaging in redistribution (i.e. in most party competition models in the literature, as well as the real world). Concavity of voting functions requires that voter uncertainty or party attachment have to be strong enough that there will be at least some voters in a given income class that continue to vote for a party no matter how adverse their treatment by the party platform. It might be more realistic to assume that once the transfer offered by a party to a given group is low enough, no voters of that group will vote for the party. Once that point is reached, there is no cost to a vote-maximizing government of reducing the transfer to that group further in order to increase the transfer, and therefore number of votes, of other groups. Given that the vote distributions of all groups will be so truncated, the conditions required for an

interior solution no longer apply, and vote cycling will be the norm. This problem will apply whether or not it is voter uncertainty or some unspecified party attachment that is at work. Unless voter distributions are very wide enough, there will be no unique interior voting equilibrium.

Introducing party ideology considerations into the model, as in Dixit and Londregan (1998) will mitigate this problem. Political parties trade off vote maximization with ideology in their objective functions, and this may preclude them from exploiting individual groups of voters enough to cause vote cycling. Such ideologies are essentially normative objectives, precisely like social welfare functions in Dixit and Londregan. Thus, political parties are seen as undertaking the kind of analysis we are eschewing—tempering normative analysis with political considerations, in this case the effect on votes. I suppose that implies that at least those normative analysts who advise political parties must necessarily take political consequences into account.

Citizen Candidate Models

Party competition models assume that political parties can commit to pre-announced political platforms, even those that go against their self-interest or ideology, in order to get elected. Citizen candidate models, on the other hand, are premised by the notion that candidates for office cannot pre-commit. Once they are elected, they are bound to do what is in their own self-interest, and voters know that. This not only tempers the kinds of policies that are eventually implemented, it also tempers the candidates that choose to run for office.

Citizen candidates might also avoid the cyclical majority problem, partly by drastically cutting down on the number of candidates and therefore on the competing policies. Indeed, the possibility of equilibrium (perhaps multiple) is an attractive feature of these models. However, there are a number of drawbacks to the model that make them ultimately unsuitable for use as a constraint on normative analysis. Three drawbacks are as follows:

1. The models are inherently implausible as descriptions of actual political decision-making. There is no role for political parties and their platforms, which might

otherwise be viewed as commitment devices. At best, citizen candidate models might be relevant for countries with weak party discipline, such as the USA.

2. Related to the first point, citizen candidate models are essentially models of elected dictatorship, since they are posed as models in which an individual politician seeks office and, once elected, carries out those policies that are in his best interest. They cannot represent the kind of representative democracy in which decisions get taken in legislatures.
3. Citizen candidate models do not really get around the problem of vote cycling. Even if individual candidates cannot commit to policies that are not in their self-interest, once they are elected on behalf of a particular constituency, they join a legislative body consisting of elected representatives from other constituencies. At the stage of decision-making in legislatures, the same kinds of vote cycling can occur as in standard models of direct democracy

The upshot is that these models would be quite unsuitable as a basis for formulating political feasibility constraints.

There are, of course, a number of other models in the literature that capture some features of actual public choice. A popular recent one is the so-called common agency model that is used to explain the doling out of favours to industry. Although there is no doubt some truth in them, it is hard to imagine them as determining the kinds of general policies, especially broad-based redistributive ones, that characterize much economic policy in industrialized economies. The same applies to models that use rent-seeking and lobbying as means of explaining the influence of special interests in public choice. Similarly, models of Leviathan public sectors maximizing their own interest are often used, sometimes constrained by political feasibility type considerations. To the extent that these kinds of models represented reality, there would be little point in using them as a constraint on normative analysis since they would pre-determine the outcome. Indeed, normative analysis might actually serve as an intellectual discipline on the Leviathan tendencies that might otherwise exist in governments.

These criticisms of extant political economy models should not be taken as a criticism of the methodology of public choice. There is obvious social value in understanding how collective decisions are taken, and the fact that there are difficult

problems that must be resolved makes the quest that much more important. Nor do we pretend to have an answer to these problems. In particular, the possibility of vote cycling continues to pose an extremely challenging intellectual problem. Clearly some societies have managed to obtain enough of a consensus to function in reasonably stable ways. How to square that with standard models of public choice remains an important item on the agenda. For our purposes, the inability of public choice models to address satisfactorily the vote cycling problem is simply one of the arguments for pursuing normative public economic analysis unfettered by political feasibility restrictions.

WHEN PUBLIC CHOICE CONSIDERATIONS CANNOT BE AVOIDED

Despite the compelling case for pursuing prescriptive analysis without constraining the prescriptions to be politically feasible, there are some circumstances in which public choice considerations cannot be avoided. We have already mentioned the case of time-inconsistency, which might be interpreted as a sort of political feasibility constraint, albeit one that does not arise from standard public choice considerations. There are, however, a number of other cases in which the behaviour of government must be taken into account. Four examples of these are as follows. Three of them involve prescriptions that involve the mode of government decision-making itself.

Prescribing Institutional Arrangements

In some instances, the choice among policies involves not only the substance of the policy itself, but also the institutional arrangements for delivering the policy. One important example of this concerns the decentralization of decision-making in multi-level governments. This is the classic assignment problem in fiscal federalism. There are many arguments for decentralizing the provision of public services. Sub-national jurisdictions might be better able to cater to local preferences and needs, and might have better information about local cost conditions. They might also be better able to overcome agency problems in the management of public services. However, there are also some political economy considerations. Competition among jurisdictions is alleged

to affect the cost of delivering public services, and to discipline the bureaucracy. It is also said to enhance innovation and to allow for the spreading of best practices through yardstick competition. It is even said to affect the amount of rent seeking and corruption that might otherwise occur. Whether these arguments are compelling or not, it seems necessary to include them in any prescriptive analysis about decentralization. An implication of our agnosticism about the applicability of existing public choice models is that the outcome of the decentralization debate is bound to be inconclusive.

Similar issues apply with respect to the privatization debate. Much of the argument over privatization of key infrastructure industries turns on the (in)efficiency of the public sector relative to the private sector. More generally, the role of the private sector in the delivery of important public services like health and education relies to a considerable extent on performance of the public sector in delivering these services. The same might be said even for the collection of taxes and trade duties.

Interjurisdictional Fiscal Arrangements

Related to the above is the design of financial arrangements between levels of government, given the assignment of functions. In virtually all systems of multi-level government, there is a vertical fiscal imbalance, and the higher level exercises some influence over the lower level through the structure of transfers used to close the imbalance. Although there are some purely economic arguments that would support such arrangements, political economy considerations cannot be avoided. Much of the case for a vertical fiscal imbalance and for central influence is based on notions of fiscal externalities caused by fiscal decisions of lower-level jurisdictions. These necessarily rely on models of the behaviour of governments in which public choice considerations are invoked.

Constitutional Choice

Perhaps the archetypical example of prescriptive analysis where public choice considerations cannot be avoided is that of constitutional design. Of course, this is not a day-to-day decision, and it involves much more than economic analysis. The constitutions of many countries have various elements of economic prescription in them.

Some of them impose constraints on the actions government can take. Examples might include protection of minorities, non-discrimination, equality rights, and the forbidding of lower-level government decisions that violate efficiency of the internal common market. There may even be provisions that require budget balance or impose constitutional limits on debt financing. Constitutions also provide for an assignment of functions in a multi-level government system, and perhaps also on the oversight that one level may have on another. Constitutions may even set out principles of economic policy, such as minimal standards of public services, or broad statements of economic and social rights. Although these do are typically not binding in a court of law, they nonetheless presumably have considerable political and moral authority. In some cases, the constitution goes so far as to oblige governments to undertake some actions.

How one judges the economic content of constitutions presumably reflects one's views about the nature of collective decision-making. Indeed, it would be virtually impossible to write a constitution without some preconceptions about how governments are likely to behave—whether they are benevolent or self-seeking in nature, whether they are likely to be well-informed, whether electoral decision-making is stable or not, and so on.

Implementation Issues

So far we have construed public choice as being primarily concerned with the collective choice of public policies by governments. This may be too narrow an interpretation. As the literature makes clear, public choice might include not just the decisions taken by legislatures, but also their implementation by the bureaucracy. In fact, most economic policies are quite complicated. The efficiency of their implementation relies on the good management of those who are implementing the policies, and some assurance that the bureaucracy is acting in the public interest. In fact, there are lots of opportunities for inefficiency in the public sector. There will be standard agency problems at various levels: between the legislative and executive branches, between various levels of management in the public sector, and so on. There will be informational problems. Those closer to the delivery point of public services or the collection point of taxes will be better informed about the relevant characteristics of the public they are serving than

those to whom they are accountable. In fact, professionals in the bureaucracy are likely to be much better informed about how to design policies to achieve the outcomes desired by the legislators. There will also be opportunities for rent seeking, corruption and even extortion in the public sector.

These problems of public sector inefficiency ought to be taken into consideration when designing a policy. The optimal choice of a policy may well be affected by the extent to which the bureaucracy can be relied on to deliver the policy, especially if the quality of delivery depends on the effort of bureaucrats. These implementation issues may also lead normative analysts to propose alternative ways of delivering or administering public service programs, including improvements in the institutions themselves. This does not really violate the general principle that prescriptive analysis should proceed without treating political feasibility as a constraint. As a matter of semantics, we would distinguish between political feasibility—what policies legislatures would be willing to choose—and implementation feasibility—what the bureaucracy can be relied on to implement.

CONCLUDING REMARKS

We have taken the general position in this paper that normative public economic analysis—which can be evaluative or prescriptive—should not take account of political feasibility constraints. We have argued for that on the basis of practicability, but more important on the basis of principle. This is especially true for purely evaluative normative analysis. At the same time, we have suggested that there are a number of exceptions involving situations in which prescriptive analysis applied at the policy-making stage cannot ignore public choice constraints. These involve cases where the policy decision taken at one level is contingent on public decisions taken at another level.

It might be useful as a schematic device to think of there being different layers of decision-making that are involved in the formulation and implementation of any economic policy. (Motohiro Sato has suggested this scheme to me.) At the most general level, four layers or stages of sequential decision-making can be distinguished.

1. *Constitutional Stage.* At this stage, the rules governing government decision-making for the future are set out.
2. *Legislative Stage.* Here, policies are enacted by collective decision-making in legislatures. There can be more than one level of legislature at this stage
3. *Implementation Stage.* The policies enacted in the legislative stage are put into effect by the bureaucracy at the relevant level of government.
4. *Market Response Stage.* The private sector agents take their decisions, given the policies that have been implemented, and a market outcome results.

In a well-functioning world, participants at each stage take as given the outcomes of previous stages, and anticipate the outcomes of subsequent stages. There may be complications involved in so doing, such as imperfections of information, uncertainty, and lack of precision about the behaviour of agents at other stages. Nonetheless, we suppose that agents do the best they can with the information and knowledge at their disposal.

Positive analysis can fruitfully be applied at any stage. In a complementary fashion, normative analysis can come in at various places. Our concern has been mainly with prescriptive analysis applied at stage 2, the legislative stage. We have argued that a normative perspective taken at this stage should ignore political feasibility constraints *at the same stage*. However, it will take a positive perspective with respect to the implementation and market response stages. Things are more complicated if stage 2 itself contains more than one level of legislative decision-making, say, a central and a local. In this case, normative analysis of central government decision-making should take a positive perspective with respect to how local governments will respond. Indeed, part of the prescriptive analysis may involve inducing local governments to behave in a certain way. Normative analysis may certainly also be applied to the constitutional stage, in this case taking a positive viewpoint with respect to subsequent stages. This is likely to be a challenging task, given uncertainty about how the subsequent stages will play themselves out.

A couple of final caveats should be mentioned. As we have mentioned earlier, none of our argument should be taken to imply that either normative or positive analysis

is better than the other. Both are obviously legitimate lines of inquiry that have demonstrably led to many insights about the economy and the society more generally. Indeed, pursuing normative analysis with political feasibility constraints in place is itself also a useful line of research. My main point is that it is not desirable to require normative analysis to take account of political feasibility constraints.

Also, none of our discussion is meant to have any implications for the level of abstraction at which either normative or public choice analysis is carried out. In particular, it is not imperative for normative policy models to be realistic for them to be scientifically useful. Highly abstract models, such as those we use in optimal tax theory, have provided considerable insight into the policy problem, even though they do not yield policies that are applicable in the real world.