Public Choice Economics

Economenclub

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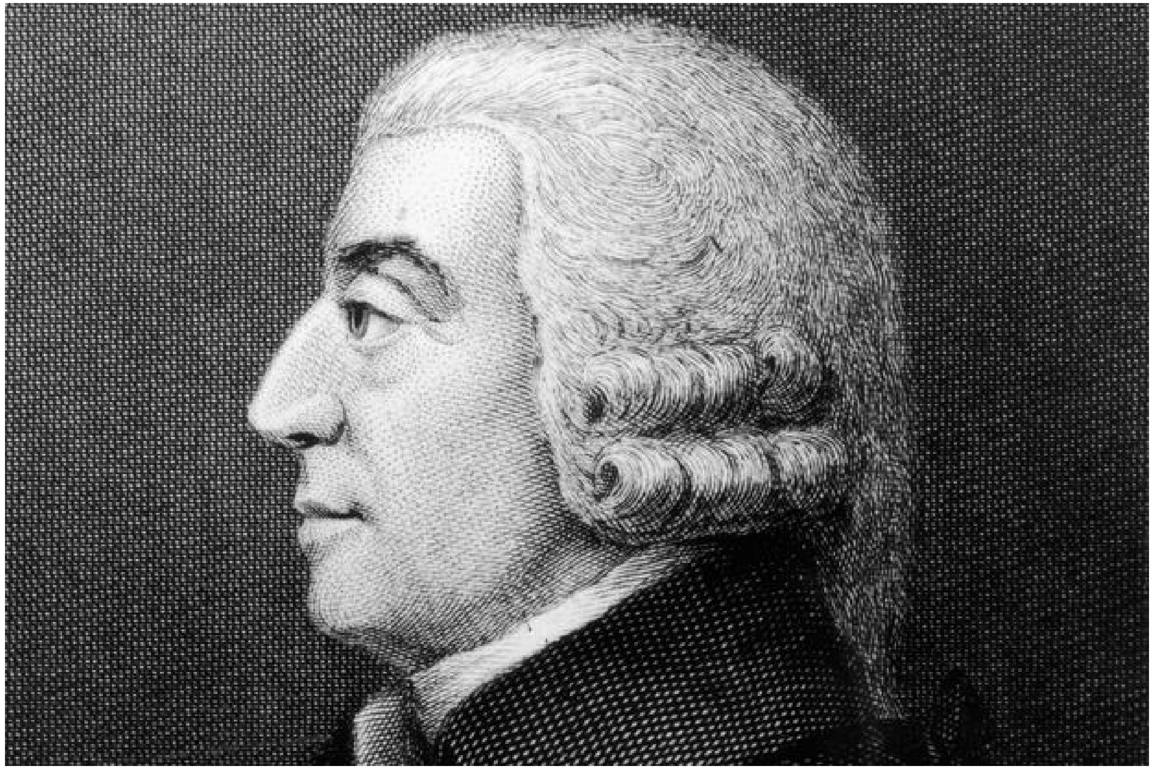
Traditional view with regards to government intervention in the market

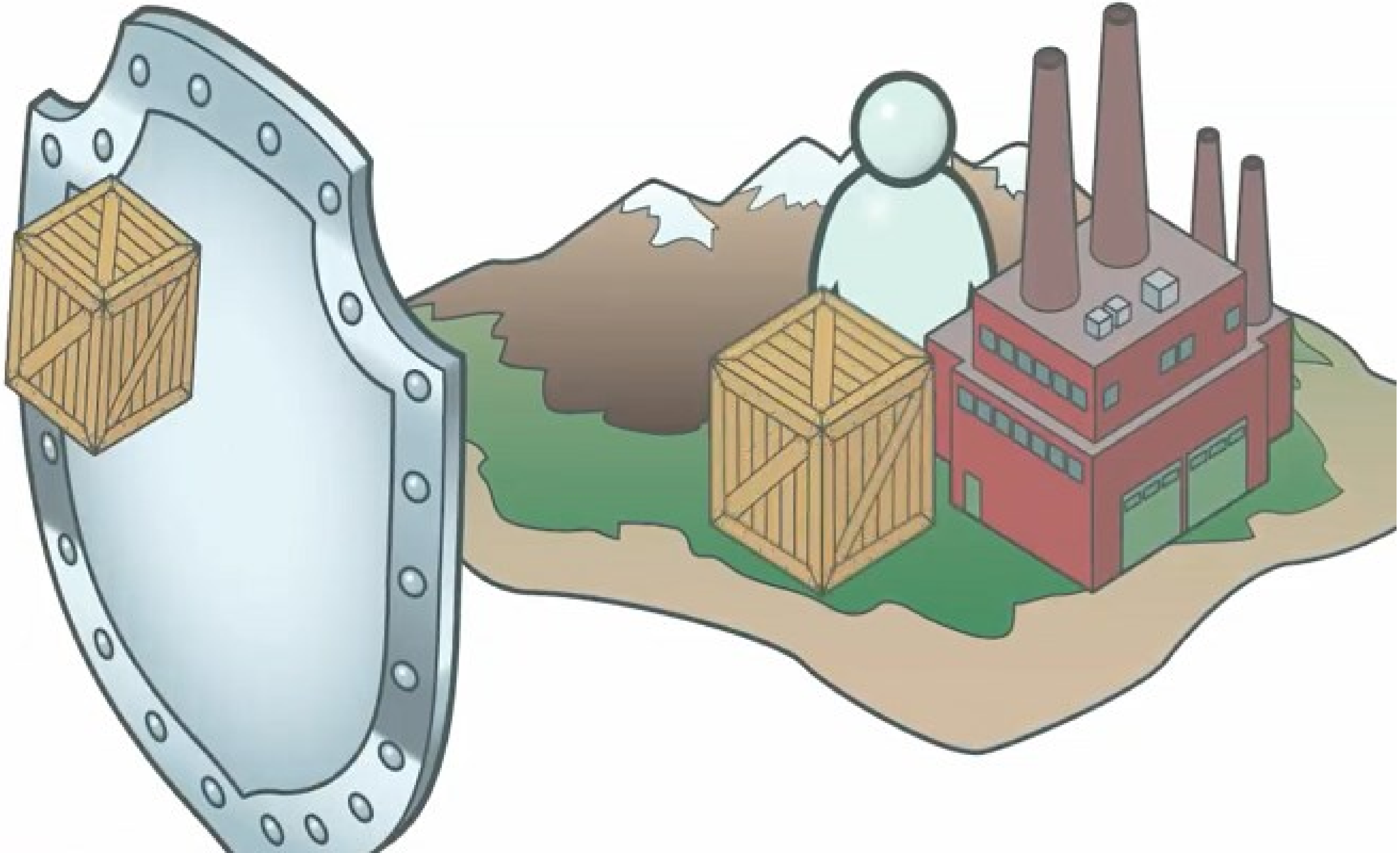
"Market failures can be viewed as scenarios where individuals' pursuit of pure self-interest leads to results that are not efficient – that can be improved upon from the societal point of view."
Krugman and Wells (2015)

“Public choice is the use of economic tools to deal with traditional problems of political science”

- Tullock (1989)

“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” – Smith (1776).





Concentrated benefits and diffuse cost (Olson, 1965)

- Politicians and public officials as brokers of privilege for special interest groups (concentrated benefits)

- Government intervention legislation as an economic conspiracy against the consumer

- Rent-seeking to acquire indirect subsidies/ wealth transfers

Rent-seeking

Component	Competitive climate	Non-competitive climate
Cost of production	$ 10 per unit	$ 10 per unit
Profit mark-up	$ 5 per unit	$ 10 per unit
Economic rent / indirect subsidy	$ 0 per unit	$ 5 per unit
Market price	$ 15 per unit	$ 20 per unit

A numerical estimation of the investment value of lobbying expenditures (Tullock, 1989)

	Scenario A	**Scenario B**
Producers		
Cost to upgrade & innovate	$ 1,000	$ 15,000
Cost to lobby legislators to impose output restrictions	$ 5,000	$ 5,000
Consumers		
Counterbid expenses by the diffuse cost group to lobby legislators to **NOT** impose output restrictions	$0	$0

Curaçao

TAXI

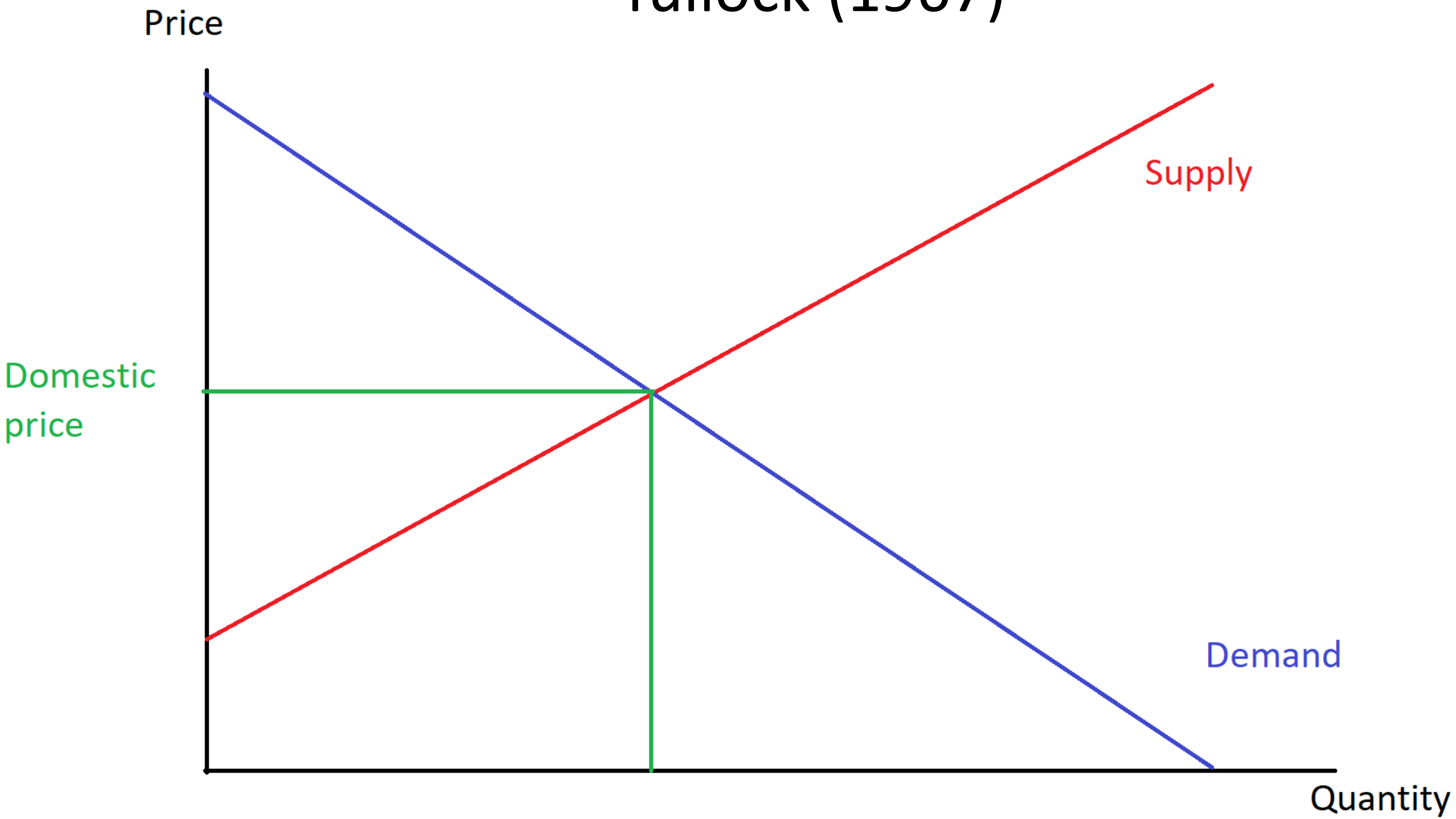
External competition	Internal competition
-Increase regulation to deter new entrants -Shuttle busses -“Illegal” taxis -Informal pick up (services) -Uber	-Price fixing (tariffs) -No competitive edge allowed unless all cartel members have it (prohibit innovation)

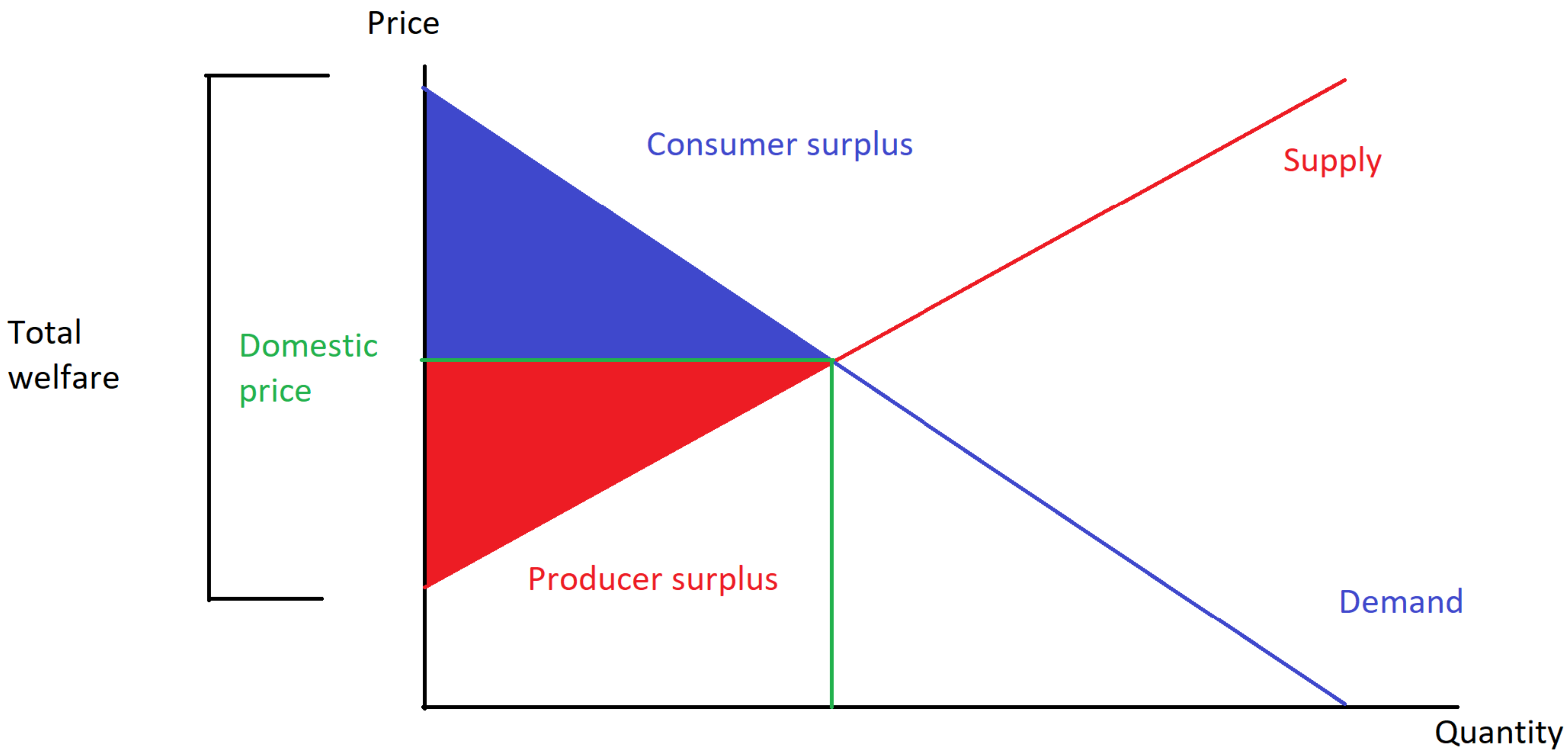
Economic consequences of rent-seeking

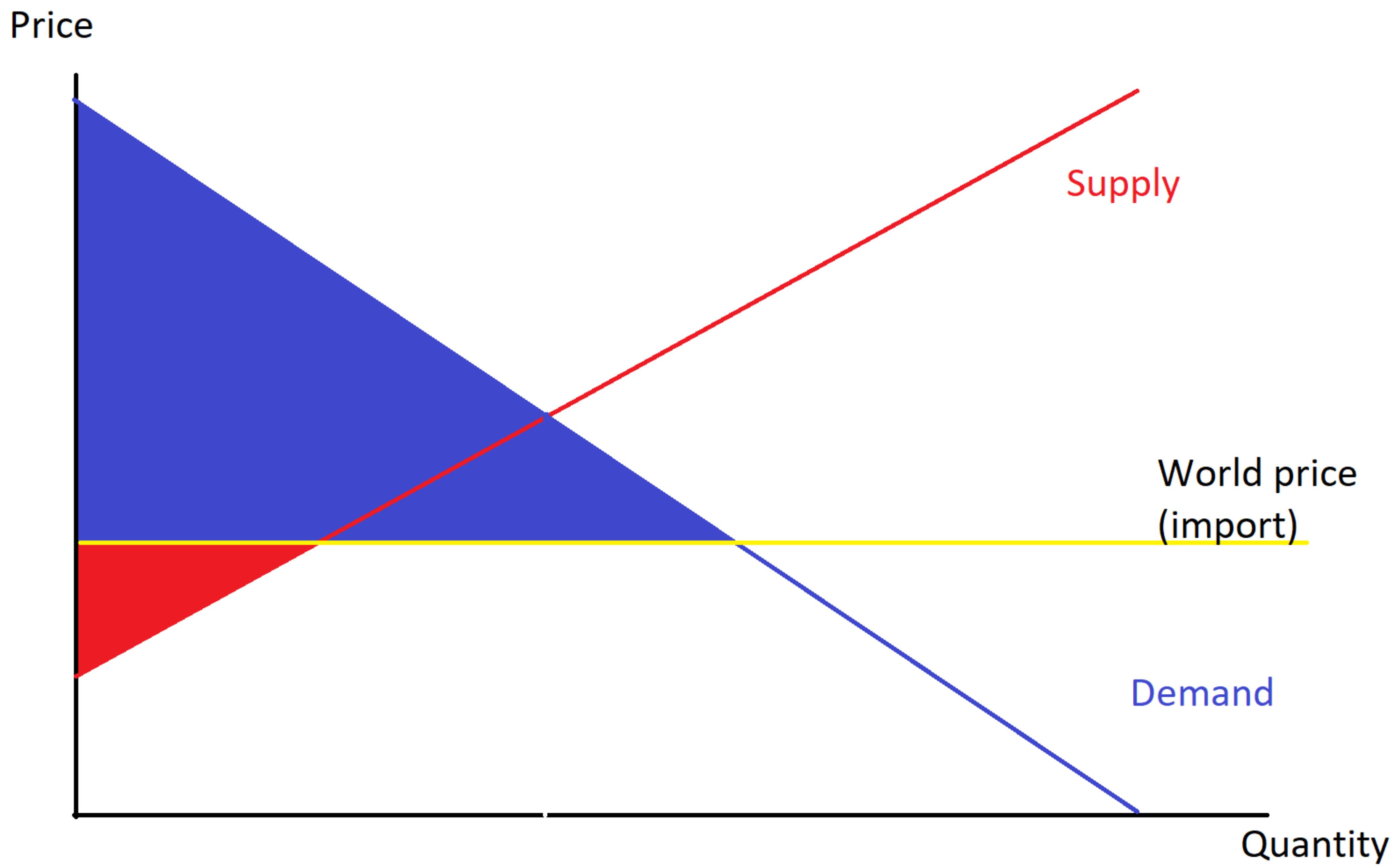
- Incentive to (be) corrupt (rent-sharing with public officials and politicians)
- Deters innovation (no innovation allowed)
- Decreases consumer surplus
- Decreases total welfare through deadweight loss


Brett Ryder

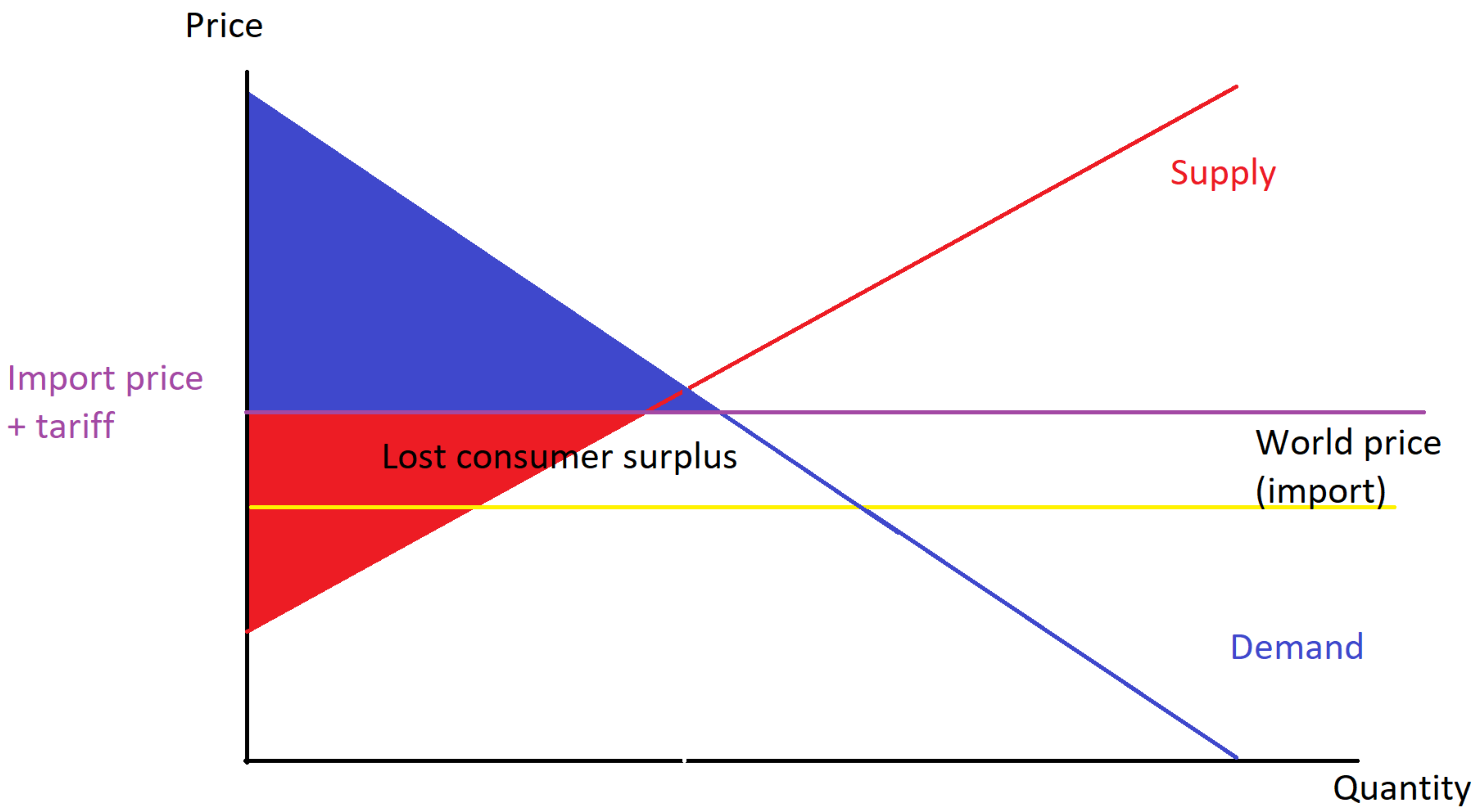
Tullock (1967)

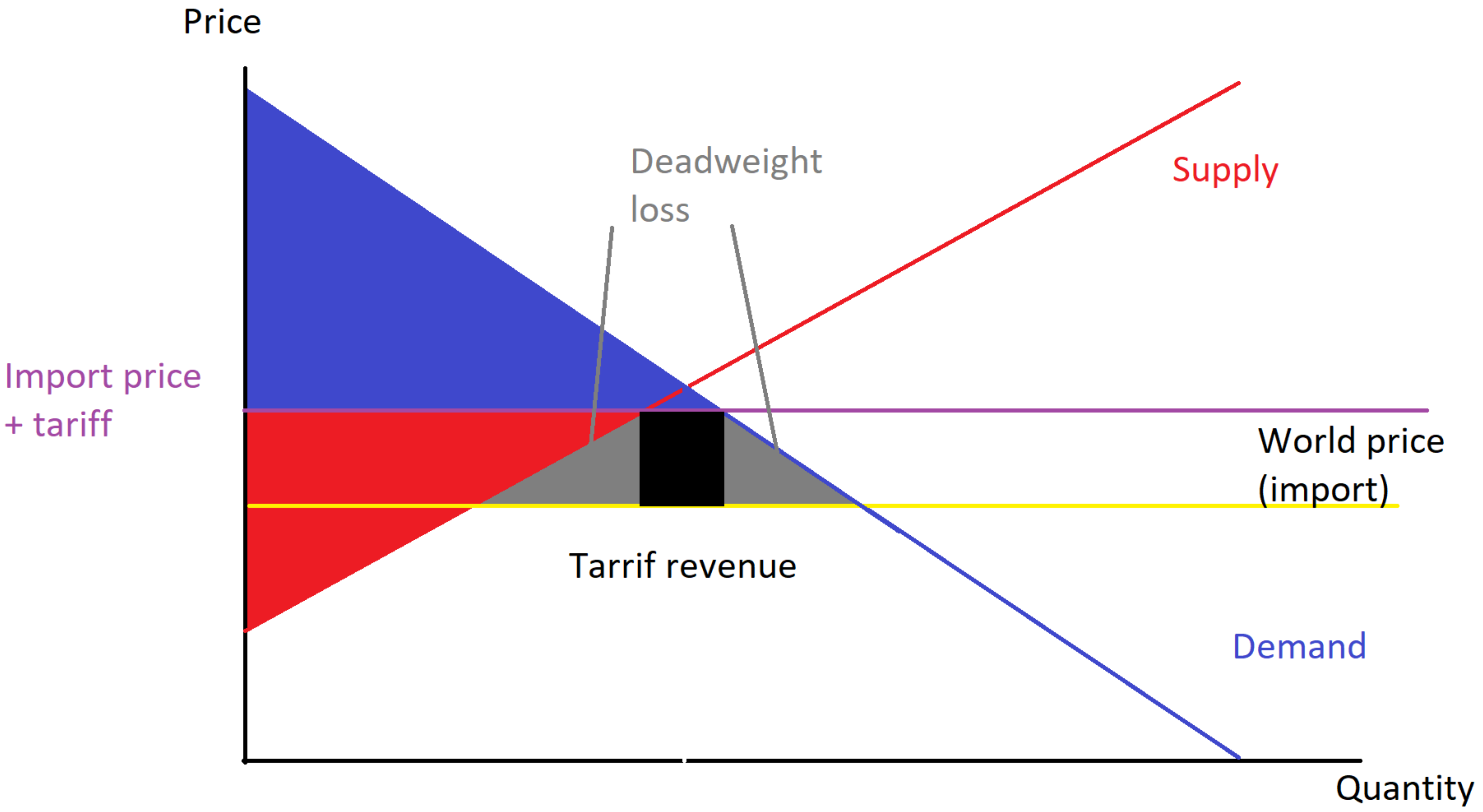



Price
Consumer surplus
Supply
Total welfare
Domestic price
Producer surplus
Demand
Quantity



Price
Supply
World price
(import)
Demand
Quantity


Price
Supply
Import price
+ tariff
Lost consumer surplus
World price
(import)
Demand
Quantity


Price
Deadweight
loss
Supply
Import price
+ tariff
World price
(import)
Tarrif revenue
Demand
Quantity

	Domestic output only	Competition from imports	Protection from imports
Consumer surplus	50	100	55 (diffuse cost)
Producer surplus	50	15	45 (concentrated benefit)
Tariff revenue	0	0	10
Deadweight loss	0	0	-25
Total welfare	100	115	85

The previous scenarios highlight why <u>**producers**</u> have an economic incentive to demand more regulation for their industry…

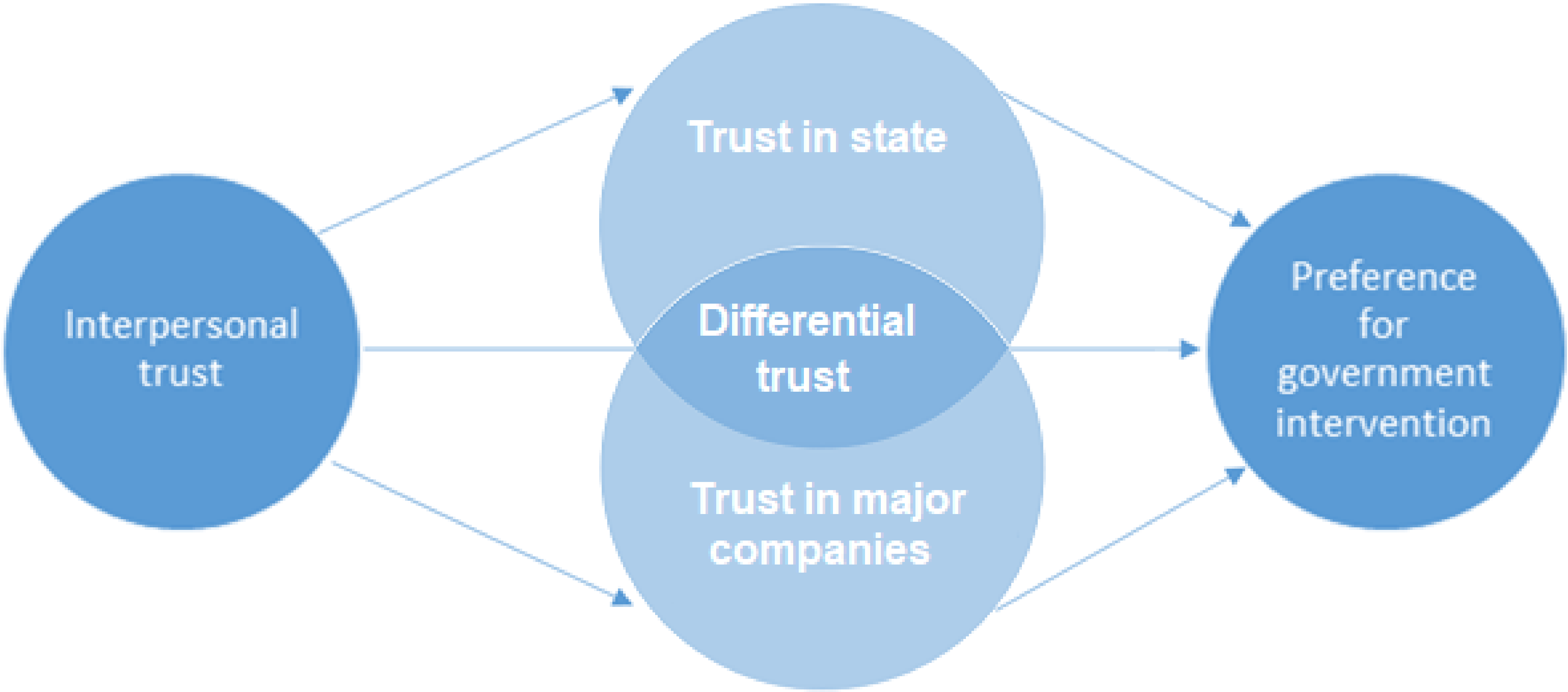
Most citizen’s have a dual role as producer and consumer in society

The preference for regulation can thus be specific to the source of one’s income.

For example: a taxi driver might be in favor of protectionist policies to prevent Uber from entering the local market, but might be against or indifferent towards protectionist policies for the import of food. A farmer on the other hand might be in favor of protectionism against food imports, but against or indifferent towards protectionism privileging taxis.

But what causes <u>**consumers**</u> to demand more regulation (red tape!!!) of business?

Social trust as a predictor of a preference for government intervention. Pitlik & Kouba (2015), Arrindell (2019)



Interpersonal trust

- Generally speaking, would you say that most people can be trusted?
- Most people cannot be counted on to do what they say they will do.
- Most people do not answer public opinion polls honestly.

Trust in state

- How much trust do you have in the civil service?
- How much trust do you have in the justice system?
- How much trust do you have in government?
- How much trust do you have in parliament?

Trust in major companies

- How much trust do you have in the major companies?
- How much trust do you have in foreign investors?
- How much trust do you have in local banks?
- How common is it for major companies to attempt to corrupt government officials?
- How much trust do you have in the business elite?

Preference for government intervention

- Should the state give firms more freedom or regulate them more?

Finding

Differential trust predicts a preference for government intervention by consumers

Recommendation to prevent and reduce red tape

If a lack of trust appears to be the driving factor for a particular type of regulation, policy makers may be well advised to inquire first about how this trust gap can be overcome instead of resorting to the traditional approach of expanding bureaucratic regulation. Arrindell (2019).

“In order to make liberalization and deregulation politically appealing it might be necessary to foster and improve alternative institutions aimed at preventing and correcting market failures”

- Pinotti (2010)

Conclusion

Producers and consumers have different motives to demand regulation from government

Producers	Consumers
Rent-seeking incentives	Differential trust

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