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Government Failure and Public Choice

Learning Objectives

By the end of this chapter, you will be able to:

- Examine the implications of self-interested behavior in the public sector (public choice) as a cause of government failure.
- Develop the concept of rent seeking.
- Analyze the effects of rent defending.
- Explain why government grows in terms of logrolling and bureaucratic incentives and why regulation creates a bias against new products and new technology.
- List some of the methods of privatization.
- Identify the contributions of the Austrian school and radical economics to understanding government failure.

Introduction

Consider this. . . Imagine for a moment that you are the chief administrator of a public entity that has just received approval from its board of directors for a significant enlargement of its mission. The difficulty you face is that growth requires significant physical expansion: You need to build buildings. In order to build these buildings, you have to sell bonds to finance the construction. And in order to sell these bonds, the citizens in your area must vote themselves a tax increase. You are well aware that tax increases are hard to pass, for obvious reasons. Is there anything you can do, besides the normal advertising and explaining of how important this expansion will be, that will increase your chance of success? This chapter might suggest a strategy. We will examine the effect of economic incentives on governmental policy decisions.

14.1 Public Choice

Public choice theory is still relatively new. A useful definition appeared in the 1993 annual report of the Center for the Study of Public Choice at George Mason University:

> Choice is the act of selecting from alternatives. Public refers to people. But people do not choose. Choices are made by individuals, and these may be private or public. A person makes private choices as he goes about his ordinary business of living. He makes public choices when he selects among the alternatives for others as well as for himself. . . While traditional economic theory has been narrowly interpreted to include only the private choices of individuals in the market process, traditional political science has rarely analyzed individual choice behavior. Public choice theory is the intersection of these two disciplines; the institutions are those of political science and the method is that of economic theory.

Public choice theory is not as optimistic as traditional welfare economics about the potential for government intervention to improve market outcomes. Public choice economists apply the same tools of analysis and assumptions to the collective choice process and to the private market. These economists recognize that there are market failures. They do not ignore externalities, public goods, unequal income distribution, and macroeconomic cycles. They do, however, demonstrate that collective choice and the intervention of government in the market do not work perfectly either. The weaknesses of the political process mean that government intervention does not work in the ideal way suggested by welfare economists. Public choice analysis begins with the assumption that people who act in a self-interested way when making personal economic decisions are the same people who vote, run for office, or are employed in the bureaucracy. Individuals bring their self-interest to the political process.

Public choice theory is as much political science as it is economics. Public choice analysis seeks to understand how economic incentives and individual self-interest affect political outcomes. For example, public choice economists expect the voter to be ill-informed because the cost of informed voting is extremely high. They view the politician as a vote maximizer, putting coalitions together to attract a majority of voters. Bureaucrats are

not profit maximizers but seek instead to maximize budgets and/or to ensure the stability of their jobs. According to the public choice economist, the result of such self-interested behavior in the public sector is that government is an imperfect intervener in its attempt to correct for market failures. One of the most important insights that emerges from public choice theory is that small groups with strong interests will often get their way politically because it is irrational (unprofitable) for the majority to oppose them.

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Public choice theory is about economics and political science. For example, public choice economists expect the voter to be ill-informed because of the high costs required to keep voters informed.

William C. Mitchell has succinctly summarized ten public sector biases that could produce this less-than-optimal intervention into the market (Mitchell, 1978). This list provides a good foundation for understanding the thinking of public choice economists:

1. Proposals with long-delayed benefits are likely to be adopted only if their costs are unknown or can be deferred or concealed.
2. Proposals offering readily apparent short-term benefits and deferred costs stand a good chance of adoption.
3. Proposals that concentrate benefits and diffuse costs stand an excellent chance of adoption. (A direct majority voting system might induce the opposite, depending on the relative sizes of the individual tax share and benefit.)
4. Proposals to abolish programs or reduce public spending have a low probability of adoption. Electoral rewards go to politicians who propose new programs or expansions and extensions of existing programs.
5. Packages of reform proposals stand a better chance of adoption than individual reform proposals, even if none of the packages' components would be accepted by a majority of voters if considered separately.
6. Direct transfer programs, which clearly designate specific and limited benefits to certain persons or groups, stand little chance of adoption.
7. Proposals that rely on inefficient, complex, multiple revenue sources are preferred over those financed by simple, direct taxation.
8. Proposals that tax market efficiency stand a better chance of adoption than proposals that reward efficiency.
9. Proposals that limit consumption (such as price ceilings and rationing) as a response to product shortages are preferred over proposals that encourage increased production.
10. Policies that protect consumers by restraining producers are preferred over policies that simply improve the information level of consumers.

The implications of these biases for policy analysis are striking. Policy problems exist because two imperfect mechanisms are at work. The market fails because of externalities, underproduction of public goods, and business cycles. The collective political process fails because the participants are responding to incentives other than those assumed by the welfare economists. Policy makers must, therefore, choose between two imperfect mechanisms in attempting to solve any policy problem. The policy maker and voter must examine the biases inherent in both the market solution and the collective political solution. It will not always be clear that the cost of intervention is less than the cost of inactivity. Therefore, the public choice approach may lead to a prescription of no intervention in many cases, on the grounds that the cure could be worse than the disease.

Economics in Action: A Discussion About Public Choice

Dr. Mark Pennington lectures on public choice theory, which claims that imperfect markets are preferred when compared with imperfect governments. Listen to Dr. Pennington's argument at http://www.youtube.com/watch?v=JAbDrP7whqw.

14.2 Rent Seeking

Economic rent is the economic return over opportunity cost. **Rent seeking** is the commitment of scarce resources to capture returns created artificially (by government or quasi-government units). Rent-seeking analysis is used by economists to describe how people or firms compete for artificially contrived transfers. Consider the case in which a government decides to confer a monopoly privilege—for example, the contract for sole supplier of food services at a state university. A great deal of effort will be spent to obtain that contract. Lobbyists will work in the legislature, firms will make campaign contributions to legislators, and lawyers will draw up contracts. All these efforts are directed toward seeking a rent that has been artificially created by the state. None of this activity will cause the price of the contract to fall, as in the case in which rents are eroded by normal competitive forces. This rent seeking is a real cost to society because competition for governmentally created rents, unlike the "real" rents discussed earlier, does not generate increased supply.

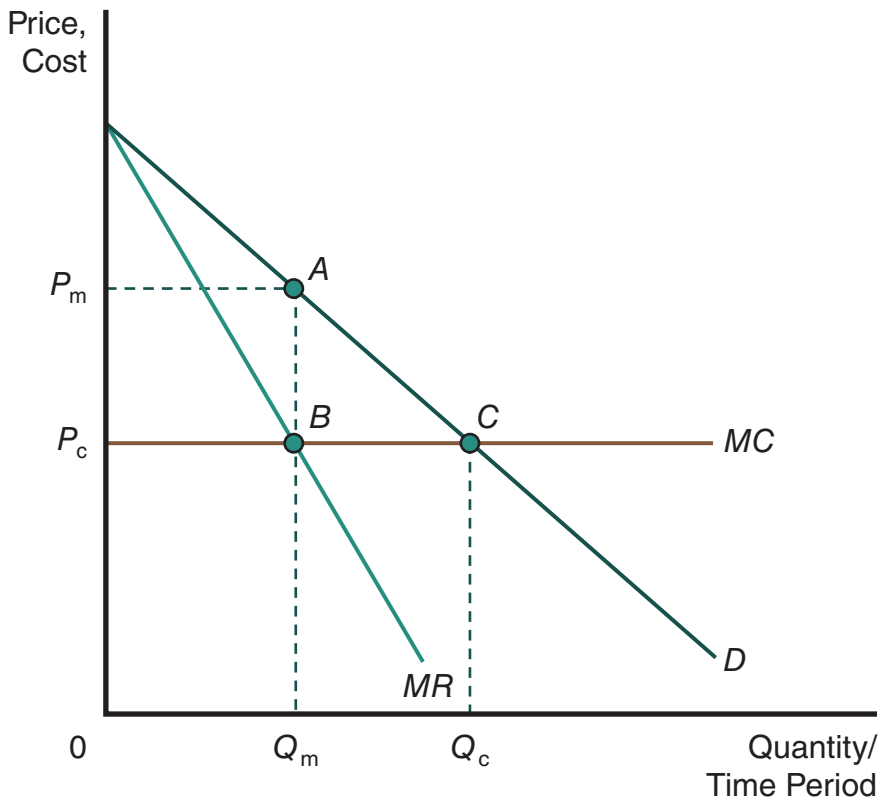
Economics in Action: Economic Rent

Dr. Michael Hudson discusses the importance of economic rent and its impact on the tax system. Discover this impact by watching the lecture at http://www.youtube.com/watch?v=Elg6i3NxvdE.

The Cost of Rent Seeking

Gordon Tullock, in attempting to measure the costs of rent seeking, was the first to develop the concept (Tullock, 1967). Figure 14.1 shows a market demand curve D yielding a competitive equilibrium (price P_c and quantity Q_c) and a monopolistic equilibrium (price P_m and quantity Q_m).

Figure 14.1: The costs of rent seeking



The deadweight loss of monopoly is the area of triangle *ABC*, but rent seeking could use up an amount equal to rectangle P_cP_mAB, as rent seekers compete for the monopoly right.

As you learned in the chapter on monopoly, the deadweight loss of monopoly is measured by the area of triangle *ABC* in Figure 14.1. The area of the rectangle P_cP_mAB is supposed to be the transfer from consumers to monopolists in the form of monopoly profits. But Tullock argues that many of the resources represented by that area do not represent a transfer from consumers to producers. The spending to capture these profits turns them into a social cost of monopoly. In fact, if competition for the monopoly were vigorous, the area of rectangle P_cP_mAB would be exactly equal to the resources wasted in competition for the monopoly privilege. The using up of economic rent in the "cost of capture" is unproductive in the sense that it uses scarce resources but does not generate any economic activity that lowers price or increases output.

Legislation and Rent Seeking

Tullock's concept of rent seeking helps to explain government action as a form of self-interested behavior by politicians and voters. Many actions of people in government can be explained by this analysis. In fact, it might be argued that an industry of rent seekers exists in most state capitals, and most certainly in Washington DC.

There are at least two broad applications of this rent-seeking theory to government actions. The first explains the types of government regulation. George Stigler described the benefits and costs to various interest groups of using the state as a vehicle to increase their own wealth (Stigler, 1971). Some groups, such as agricultural interests, seek income transfers from the state. Other groups, such as automobile producers, use the state to fend off regulation that would have a negative impact on costs and profit. In some cases, management and labor join together to use the state for their mutual benefit at a cost to consumers, such as in attempts to restrict imports.

The second application focuses on the economic behavior of legislatures. In this analysis, the politician is responsible for brokering transfers from one group to another. One can view the politician as an entrepreneur putting together coalitions of rent-seeking groups. Consider the public provision of education as an example. In the United States, education through the 12th grade is mainly produced in the public sector. A public choice economist would argue that even if education is a public good, there is no reason to believe that representative democracy can create the incentives necessary to internalize the external benefits of education. Instead, such economists expect office holders to broker benefits to certain subsets of the population, including (but not limited to) members of the educational bureaucracy and organized student or parent groups. So, what started as a correction of market failure ends in a solution that is quite far removed from the optimal correction. It might reasonably be called government failure.

14.3 Rent Defending

John T. Wenders has extended the analysis of rent seeking to how consumers spend resources defending their consumer surplus from rent seekers (Wenders, 1987). Wenders recognizes that this activity might more correctly be called consumer surplus defending, but he prefers to label it **rent defending**. Consumers would be willing to pay an amount represented by the area of rectangle P_cP_mAB in Figure 14.1 to prevent the market from being monopolized. As you saw in an earlier chapter, that area represents consumer surplus. Consumer surplus is the extra utility that consumers gain because they pay less than they would be willing to pay for the item because all units are sold for the price of the last, or marginal, unit.

Rent seekers and rent defenders are bidding for the same resources. Rent seekers are bidding for the monopoly privilege. Consumers are willing to spend a similar amount to prevent the rent seekers from acquiring a monopoly. Wenders shows that this situation is analogous to that of the Prisoners' Dilemma. If either party spends less, it will lose to the party spending more. This situation ensures that close to double the amount represented by P_cP_mAB in Figure 14.1 will be spent seeking the monopoly and defending the consumer surplus.

The concept of rent defending expands the analysis of rent seeking. The implication is that in some situations the cost of regulation is much higher than it is traditionally thought to be.

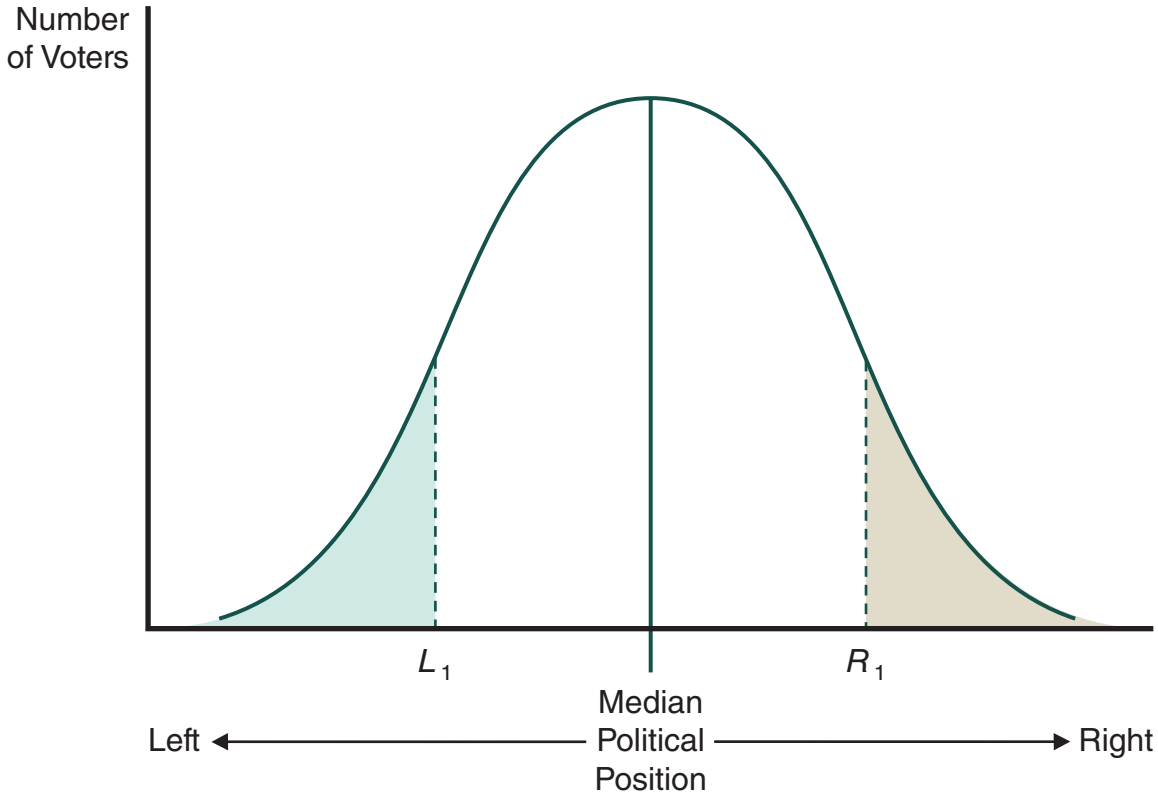
14.4 Analysis of the Political Market

According to the self-interest theory of government, the size of government increases due to rent-seeking activity by firms and individuals, and brokering activity by politicians. There are also other forces at work to influence the type of governmental programs that are created by politicians. Most of these forces tend to increase the size of government.

The Median Voter Theorem

The **median voter theorem** predicts that under majority rule, politicians will adopt the positions of voters near the center of the political spectrum. To see why, refer to Figure 14.2. Assume that political preferences in society are continuous from left to right and distributed under the normal curve in the figure. If there are two candidates, R_1 and L_1, who are at equal distances from the center, they will get the number of votes represented by the area under the curve on their side of the median line. They tie at the polls. Candidate R_1 will realize that he can steal some votes by moving toward the median, because he can count on all the voters to his right. Candidate L_1 will realize what is happening, and she will also move toward the center in an attempt to get a majority of the votes cast. As a result, both politicians will end up near the median political position, where there are the same number of voters to the left and the right.

Figure 14.2: The median voter model



If two politicians are running against one another, they will both move toward the median position to capture votes.

The median voter theorem can be used to explain why public spending is aimed at groups in the middle of the political stream, especially in a two-party system. Why, for example, do politicians promote programs to spend more money on education in general than they do for education for poor kids? The median voter theorem is also the basis of Stigler's and Tullock's argument presented in the chapter on income distribution—that most of the redistribution of income will be from the rich and the poor to the middle class.

Economics in Action: The Scoop on Median Voter Theorem

The Median Voter Theorem is illustrated through the competition between two ice cream vendors who sell the exact same product in a neighborhood block. What do the vendors decide to do to gain an advantage? Find out by watching the video at http://www.youtube.com/watch?v=cFt0k6n_HKc.

Logrolling

When many issues are before a legislative body at the same time, the outcome most preferred by voters on some issues may not result. This failure is due to **logrolling**, which is a form of exchange in which politicians trade support on one issue for support on another issue. Logrolling is the direct exchange of support. The senator from Oklahoma votes for the military base in South Carolina in exchange for a vote by the senator from South Carolina for the water project that will make Tulsa a seaport.

Economists can't say much about the properties of logrolling except that it does not necessarily produce optimal levels of public output. The size of the budget is likely to be too large and its content may be altered as a result of logrolling. The overall outcome depends on the coalitions that surface. It is probably safe to infer that logrolling does not enhance the efficient use of resources.

It often is argued by economists that geographically based representative democracy and logrolling produce too much "pork barrel" government spending. This excess spending results because citizens see the cost of their local projects being shifted to citizens of other states or districts and reward their elected officials for delivering such projects. As most representatives attempt to be successful at this political game, logrolling creates larger than desired levels of government spending.

Policy Focus: Why Are Voter Turnouts So Low?

When election time rolls around, voters are bombarded with commercials and e-mails concerning their civic responsibility to vote. These statements are often accompanied by complaints about low voter turnouts for U.S. elections. You may even be told by your local newspaper's editorial writer that "if you don't vote, you can't complain."

But think about it rationally for a minute. What are the costs of voting? You must register to vote. You must spend time getting to the polls. You must wait in line at the polls. Most importantly, you must spend time becoming informed on the issues and the candidates. What are the ***(continued)***

Policy Focus: Why Are Voter Turnouts So Low? ***(continued)***

benefits of voting? It is possible that you might be able to affect the outcome, but the probability of your vote being important is tiny, especially in national elections. Perhaps you vote because you get a feeling that you have done your duty, or you receive satisfaction from participating in civic affairs. These feelings must be important, or even fewer people would vote. This is a consumption motivation for voting.

If we really wanted more people to vote, we would need to make it less costly to vote. In Europe, most countries vote on Sundays. Some states make election day a legal holiday to encourage voting. It's not clear whether this increases or decreases the cost of voting! If you don't think costs affect turnout, answer this question: Do more people vote when the weather is nice or when it is bad?

How could the cost of voting be lowered or the benefits increased? Some methods are postcard registration, transportation to the polls, and more voting places so that lines are shorter. In 2003, Texas introduced what it calls, "No Excuse Voting." All Texas counties are required to begin early voting 17 days before an election. You can stop in anytime during this time and cast your vote. Early voting is certainly more convenient, which should greatly reduce the cost of voting. There was a slight increase in voter turnout in 2004, but the overall trend since early voting in Texas began has revealed no dramatic increase in voter turnout. More convenient does not translate into more voters (Progressive States Network, n.d.).

If you think about it, perhaps you could suggest even more voter-luring techniques to your local election board. In 2012, the Obama campaign employed a staff of 20 full-time email writers who drafted and experimented with different versions of subject lines (Dwyer, 2012). Facebook, Twitter, and other social media outlets also played an important role in recruiting voters, fundraising, and sharing information. Even with the push to "Get Out the Vote," roughly 60% of eligible voters elected instead to skip the polls in 2012 (Kanalley, 2012). Maybe there are some people out there who are happy with low turnouts! Who might they be?

Bureaucrats and Bureaus

Once a governmental unit has decided how much of a public good to produce and how to pay for it, the legislature and the executive branch (president, governor, mayor) usually turn the job of supplying the good over to a bureau—a government agency or department. In a few cases, governmental units simply purchase privately supplied goods with tax revenue. A classic case of using private suppliers exists in Scottsdale, Arizona, where part of the fire protection is privately supplied and part is provided by the local government. Garbage removal is privately supplied in many communities. Often, however, a bureau is responsible for production of a good in the public sector.

The role of bureaus and bureaucracy creates many problems in supplying public goods. It is extremely difficult, if not impossible, to monitor the efficiency of a bureau. Bureaus do not usually produce measurable outputs. Instead, they produce activities. For example, a bureau might produce fire protection, education, or defense. When legislatures monitor these activities, they tend to examine spending rather than measure outputs. Citizens, however, are more interested in output levels. Sometimes there is a partial measure of output, such as the number of students educated or length of response time for fire-fighting units. But how can the value of the output of the Department of Defense be measured?

The value of output must usually be inferred from the activity of the bureau, and that activity is most often measured by the level of expenditure. Thus, complaints about the quality and quantity of education or defense are generally reduced to calls for increased spending on the activity itself.

Andrew Council/Aurora/Getty Images

A classic case of using private suppliers of public goods exists in Scottsdale, AZ, where part of the fire protection is privately supplied and part is provided by the local government.

Monopoly Problems

The problem of monitoring bureaus is further complicated by the fact that bureaus are almost always monopoly suppliers dealing with a single purchaser, the government. This relationship makes the monitoring function of the government committee charged with oversight of the bureau difficult at best. The rationale for a monopoly supplier is that it avoids inefficient duplication. This reasoning may or may not be valid. However, the monitoring committee has no competing information by which to judge the bureau's efficiency.

This point has become a hot topic in debates concerning the public funding of education. Some leading policy critics suggest a voucher system as a way to introduce competition into public education. Under a voucher system, each student receives a "ticket" that can be used for tuition at any school. The hope is that the resulting competition will improve the quality and quantity of publicly financed education. Teachers as a group are opposed to the voucher system concept. If you think about it, a voucher system in primary and secondary education would be a lot like state support of higher education. The state "pays" public colleges and universities based on their enrollment, and the state colleges and universities compete with each other (and with private colleges) for students. It isn't a perfect analogy, but a fairly close one.

Budget Maximizing

Still another problem in monitoring bureaus is created by the way in which bureaucrats are rewarded. As we discussed in a previous chapter, entrepreneurs or hired managers in the private sector generally lay claim to any profit and, therefore, have ample incentive to increase efficiency. In a public bureau, the manager has no such stake. In fact, it may even be that the bureau manager's salary is inversely related to efficiency. This perverse situation can result when salary increases are tied to the size of the budget and the budget grows (in part) because of inefficiency.

There are many possible goals that bureaucrats substitute for the private manager's goal of profit maximization. Among these other motivations are salary, perquisites of the office, power, public reputation, patronage, bureau output, ease of management, or investment in future private sector employment. Government officials need to keep these competing

motivations in mind when they establish bureaus and when they evaluate bureau managers' behavior. There is an internal contradiction in expecting a government official to try to control the size of a bureau.

What Is the Answer?

These problems of government intervention lead to disturbing conclusions. You saw in previous chapters, especially the one on monopoly, that markets do not always produce ideal results. The chapter on market failure and government intervention added externalities and public goods to the list of market failures. But this chapter has shown that political action designed to correct market failure introduces a whole new set of problems. The net result is a messy one. Markets may fail, but governments also can fail. Government and government representatives do not always work in the public interest.

In fact, the conclusion of public choice theory is that there is no such thing as "the public interest." It is instead correct to say "the self-interest of groups working in the public sector." As we said in the beginning, this conclusion is not as optimistic as a political science approach that assumes that certain political actors have high "public interest" positions. Contrast, for example, what you have learned in this chapter to a traditional political statement such as, "It is time we start thinking about the common good and the national interest, instead of just individuals in this country" (Clinton, 1993).

This view of government failure as a parallel to market failure has been widely accepted among policy makers and voters. The important point is that economists can attempt to identify market failure and government failure and allow policy makers to sort out the least harmful solution to policy problems that affect everyone.

14.5 Privatization

One policy movement, often referred to as privatization, has worked against the tendency of governments to grow. **Privatization** is the transfer of governmental activities and/or activities and/or assets to the private sector. In many industrialized countries, including France and the United Kingdom, and also in Latin America, privatization has been the norm for about thirty years. It involves not only sale of state enterprises to the private sector, but also contracting out certain kinds of public services paid for with taxes to private firms (such as management of prisons and hospitals). The scale of privatization in Central and Eastern Europe was much larger, however, since virtually all productive assets other than labor were owned by the government prior to the 1990s (Bjørnskov & Potrafke, 2011). In recent years, even the communist state of China has gradually adopted some forms of privatization with positive results (Bai, Lu, & Tao, 2009). In the United States, privatization has been done mostly by local governments, but the concept may spread to state and federal governments. U.S. cities and localities have used five methods to privatize services.

The advantages of privatization are that it reduces government spending and is politically feasible because it does not eliminate the service. The spending reductions come from several sources:

1. Privatization introduces competition and the resulting efficiencies.
2. It permits smaller localities to join together into more efficiently sized units for purchasing services.
3. It removes government from labor negotiations and retirement commitments.
4. It transfers revenue-consuming activities to private firms that pay taxes and produce revenues.

Privatization can also result inadvertently from failure of governments to deliver a quality service. United Parcel Service's (UPS) success in competing with the U.S. Postal Service in delivering packages and overnight mail is perhaps the best example of such a governmental default. Privatization will continue to be an important policy topic for state and local governments in the 2010s and beyond as the United States attempt to reduce its debt.

Check Point: Methods of Privatization

Method	Operation	Example
Contracting	Government bids out activity	Cabs and buses
Franchising	Government grants franchise	Garbage pickup
Vouchers	Government gives "tickets" and public buys	Education
Subsidies	Government gives grants	Cultural activities
Tax incentives	Government grants tax credits	Child care

14.6 Austrian and Radical Economists and Governmental Failure

Public choice economists, whose ideas were outlined earlier in this chapter, apply microeconomic analysis to the political process. We now draw your attention to two other schools of economic thought. Both offer some useful insights on the appropriate role of government, policy making, and the nature of government failure.

The Austrian School

The Austrian school has its roots in the work of Ludwig von Mises and Nobel laureate F. A. Hayek. Economists of this school start their analysis from the assumption that policy makers make economic decisions in a state of partial ignorance. Individual consumers and producers plan with incomplete and/or incorrect knowledge of the future. Markets play the role of providing feedback, which coordinates actions as individuals adjust their incorrect plans to changing relative prices. Individuals are frustrated, but by adjusting to changes in relative prices they are better off than they would have been before the adjustment.

The Austrian school is in many ways very close to public choice theory. Economists of the Austrian school argue that political manipulation of the economy is microeconomic in nature, rather than macroeconomic. In their view, politicians do not seek to influence the unemployment rate or the inflation rate, but rather try to influence certain markets for their own gain. For example, one politician may work to create subsidies for farmers. Another may work for aid to urban slum dwellers. The result of these actions is that the size of government increases, with many programs that are difficult to control, much less to reduce.

Economists of this school take a strong stand against governmental planning. This stand is based on four points made by one of the best-known members of the school, F. A. Hayek. The first is that planning always results in more planning because people will circumvent the rules of the planner. As a result, the planner will devise more rules, which lead to more circumvention, which produces still more rules. Hayek referred to this process as "the road to serfdom." Hayek's second point about governmental planning is that no matter how detailed the plan, it can't cover all the specific cases. A bureaucracy will be needed to implement the plan. This bureaucracy will grow powerful and corrupt. Havek's third point is that high morale is so important to the success of governmental planning that any critics of the plan must be silenced. Hayek's last point is that "the worst get to the top"; that is, that governmental planning leads to a dictator.

One of the great appeals of Hayek's work is that it describes the path followed by many countries that have tried central planning. The Austrian school would argue that the problems of the former Soviet Union and the People's Republic of China were caused by planning, and reforms such as those proposed by Gorbachev in the late 1980s were doomed to fail.

Paul Popper/Popperfoto/Getty Images

The Austrian school is rooted in the works of economist F. A. Hayek, pictured in the center of the image above. In many ways the Austrian school's views on links between economics and policy making are very similar to those of public choice theory.

Perhaps the leading spokesman of the Austrian school in the United States was Murray Rothbard. Professor Rothbard viewed conservative economists suspicious of government intervention as "wimpy moderates" because they do not view all government intervention as "not only ineffectual, but also pernicious, and counterproductive." Rothbard and the Austrian school opposed any intervention in the macroeconomy. Although they believe that money matters in the economy, they don't think that monetary policy can be carried out because it requires impossibly precise assumptions about the economy.

Global Outlook: Privatization in Africa

The story of privatization in Africa is an interesting one, primarily because of its ability to reduce the great financial burden on the government while also potentially stimulating private economic growth. Until 1996, privatization in Africa had been slow. By 1997, the number of transactions had increased to roughly 2,900, with a cumulative total sale value of around $6 billion (White & Bhatia, 1998). In contrast, privatization revenues in Italy alone generated $112 billion from 1990 to 2001 (Mahboobi, 2002).

In 2005, John Nellis of the *Center for Global Development* examined the process and progress of African governments in a movement towards privatization and found that African states had privatized a far smaller percentage of their state-owned and operated infrastructure companies (SOEs) than in Latin America or several transition economies. Also, of the privatization that had taken place, it was in smaller and less valuable industries like low-end manufacturing, while infrastructure privatization remained stagnant (Nellis, 2005). Table 14.1, reproduced from Nellis's study, shows the government's share of ownership before and after privatization from 1991 to 2001.

Table 14.1: Government's share of equity before and after privatization

Sector	Average government's share of equity	Percentage (%)
Manufacturing and Industry	Before privatization	79.7%
	After privatization	7.9
Agriculture, Agroindustry, and Fisheries	Before privatization	79.5
	After privatization	1.6
Services, Tourism, and Real Estate	Before privatization	70.2
	After privatization	14.3
Trade	Before privatization	95.3
	After privatization	3.3
Transport	Before privatization	97.6
	After privatization	4.9
Financial	Before privatization	86.7
	After privatization	8.2
Energy	Before privatization	88.3
	After privatization	46.5
Water	Before privatization	100
	After privatization	12.5
Electricity	Before privatization	100
	After privatization	33
Telecoms	Before privatization	95.8
	After privatization	42.8

(continued)

Global Outlook: Privatization in Africa ***(continued)***

Table 14.1: Government's share of equity before and after privatization

Sector	Average government's share of equity	Percentage (%)
Other	Before privatization	63.3
	After privatization	10.2
Total average government's share of equity before privatization		89.1
Total average government's share of equity after privatization		10.3

From Nellis, J. (2005). Privatization in Africa: What has happened? What is to be done? *Center for Global Development Working Paper No. 25, p. 10, Table 4. Reprinted by permission.*

One reason for the lag may be because privatization has not gone so smoothly in many regions. For example, in Zambia, the process of privatization was once referred to as a successful program by the World Bank. However, public perception became increasingly negative as allegations of mismanagement and corruption erupted. Resentment has resulted over the closure of firms previously run by Zambians.

What should be done? Nellis (2005) recommends that African states "create and reinforce the institutional mechanisms that guide and regulate sales and market operations" (p. 25). What does that mean? African states need to make sure that their procedures and methods of privatization are efficient, free of political interference, and that contracts are enforceable. Otherwise states will be unable to attract and retain the investment necessary for successful privatization.

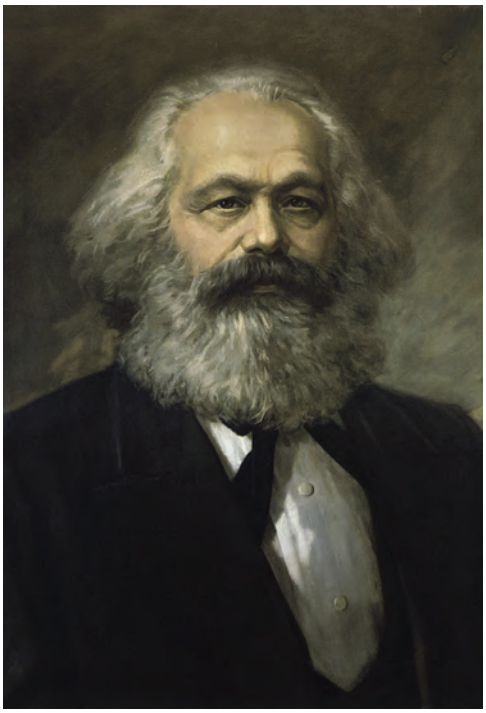
Radical Economic Thought

Unlike the Austrian school, radical economists are critical of both the market and government in a capitalistic system. Radical economists in the United States draw on the tradition of Karl Marx and Marxist thought. These economists do add several new lines of attack on capitalism. The basic difference between radical economics and other schools of economic thought is that most other economists see a basic harmony in the economic system and believe that most problems can be solved by relying on market forces. However, radicals contend that solutions to the problems of modern capitalism can only be found by restructuring industrial capitalism. In addition, radical economists regard orthodox economists as being much too narrow in their analyses.

The main themes of radical economics are monopoly power, state power, exploitation, imperialism, and waste and alienation. Radicals believe that the U.S. economy is dominated by large corporations and that small firms play an insignificant role. They believe that these large corporations set arbitrary prices and manipulate consumer wants. The state is viewed as the protector and fostering agent of the powerful monopolies. The radicals see the federal government as controlled by big companies. They believe that the state sets economic policy, including defense spending, in the interest of big business.

Radicals, unlike Austrians, are very critical of the private sector. For example, they challenge the marginal productivity theory of income determination (discussed in an earlier chapter). Radicals argue that monopolistic firms, unequal opportunity, and the unjustifiable private ownership of capital make this theory defective. They base their description of incomes on dual, or segmented, labor markets. **Dual labor markets** result from artificial barriers in labor markets that trap some workers in jobs with low wages. Radicals argue that these two labor markets consist of one in which pay is good and advancements are possible, and a second in which pay is low and opportunities for advancement are nonexistent. These dual labor markets are a result of a conscious effort on the part of capitalists to restrict advancement to certain groups in the labor force. As a result, a large fraction of the labor force is doomed to dead-end jobs for life, with low pay, little job security, and no opportunities for advancement.

Finally, radicals argue that resources are wasted in a capitalistic system. This waste is the amount of money spent on such items as expensive autos, furs, alcohol, and drugs, as well as the billions of dollars spent on advertising, which radicals claim is used to manipulate consumer wants. Radicals argue that this waste and the power of monopolies contribute to alienation. Since individuals have little control over their destiny, they consume high levels of unnecessary consumer goods and feel alienated from society.



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Radical economic thought draws from Karl Marx and Marxist thought. Radical economic thought contends that most problems can be solved via market forces.

Radical economists have challenged the mainstream to examine more closely some of the weaknesses of capitalism. The response of most economists has been to not take the radicals too seriously (nor to ignore them completely). Radical ideas have, however, led to suggestions for "tinkering" with capitalism in some areas, especially in control of monopoly power. The radicals have also provided useful insights into how special-interest groups use government to serve their own self-interests. These insights are not unlike those of public choice economists. The most serious weakness of the radical economic critique of capitalism is that it has concentrated on criticism without offering feasible solutions.

Summary

Consider again. . . Return to the public bond issue that you are in charge of getting passed. Is there anything you might do to help your own cause? A good example of what you might do occurred in Tarrant County, Texas. Tarrant County Junior College (TCJC) wanted to build an additional campus. They received approval from their

governing board and then had to go to the voters in a bond election to have them approve a tax increase to pay for the campus. Tax increases are not easy to pass! There are a few people who will gain from the tax increase. Students who will attend certainly will gain. But most potential students aren't even of voting age yet. Faculty and staff will gain. Most of them haven't been hired yet. Certainly there are enlightened business people and citizens who favor education and will come to the polls and support the bond issue. There are, however, a lot of people who will lose through higher taxes. They will lose only a little because it is a very small tax increase and it is spread over a very large county.

Therein lies a strategy. Pick a time for the election when the bond issue is the only item on the ballot. That is exactly what the administration of TCJC did. They could have picked a special election held in Texas to pick a new U.S. senator. They could have picked a time when there were city and county elections all over Tarrant County. But they didn't; they picked a Saturday in July when the bond issue was the only thing on the ballot. Those people who had a direct interest in the expansion of TCJC turned out and voted for the bond issue. The larger group of voters who would have had an interest in the U.S. Senate election and/or had an interest in the city elections did not go to the polls. They were uninterested or maybe didn't even know there was a special bond election.

So you see, voter turnout is a double-edged sword. It depends whose side you are on. Sometimes policy makers might be just as happy if some voters stayed home!

Key Points

1. Public choice theory identifies biases in the political process and applies economic analysis to political processes and outcomes.
2. Rent seeking is the economic description of individuals' use of the political process to generate income transfers to themselves or to groups they support.
3. Rent defending is the process by which consumers attempt to defend their consumer surplus from rent seekers.
4. The median voter theorem suggests that, under majority rule, politicians will adopt positions near the middle of the political spectrum. Logrolling in a legislature increases the size of budgets. Legislators agree to vote for a colleague's project in return for a vote on their project. Bureaucratic decision making is different from firm decision making because bureau managers face a different set of incentives than private sector managers do. All of this type of behavior tends to increase the size of government. Government regulation introduces a bias against new products and new technology.
5. Privatization of government assets or activities permits provision of goods and services to be done more efficiently by relying on market (and other) forces.
6. The Austrian school of economic thought assumes that decision makers proceed on the basis of incorrect and/or incomplete information. The school makes a strong case against economic planning by governments. Radical economics, which is related to Marxism, is based on the belief that monopoly capitalism, protected by government, is manipulative and exploitative. Both groups have added to our understanding of government failure.

Key Terms

dual labor markets The existence of two separate labor markets because of artificial barriers that keep some workers earning low wages.

logrolling Vote trading in the legislative process.

median voter theorem A theory that predicts that, under majority rule, politicians will reflect the positions of voters near the center of the political spectrum.

privatization The transfer of governmental activities and/or assets to the private sector.

rent defending Actions by consumers to keep their consumer surplus from being captured by rent seekers.

rent seeking The commitment of scarce resources to capture returns created artificially.

Critical Thinking and Discussion Questions

1. Why do bureaucracies not always serve the public interest?
2. What is the Austrian school's argument against government planning?
3. What is public choice theory?
4. Why is it so hard to cut programs once they have started?
5. What is the median voter theorem?
6. Why, according to public choice theory, is it not rational to vote?
7. How do radical economists challenge the marginal productivity theory of income distribution?
8. What is rent defending and how does it compare to rent seeking?
9. How can logrolling increase the size of government?
10. When could a bureau manager's salary be inversely related to efficiency? What problems could this cause?
11. Is it possible for interest groups in Washington to engage in logrolling? How would they do it?
12. What are a few ways the government could improve voter turnout? Why might this be a bad idea?
13. Should the government intervene in every case in which an externality exists? In what situations might it be better not to intervene?
14. Why do government programs that concentrate benefits and diffuse costs have a better chance of being enacted than those that benefit many and impose costs on a few?
15. Give a few examples of current government entities that could possibly be privatized. What potential goals would privatization accomplish?