

Markets & Democracy

Session 2

PMAP 8141: Microeconomics for Public Policy
Andrew Young School of Policy Studies

Plan for today

Markets and institutions

Markets, trading, and prices

Governments in the economy

Democracy and factions

Small factions and public goods

Government failure

Markets and institutions

What is a market?

**An institution used
for organizing society**

“A way of connecting people who may mutually benefit by exchanging goods or services through a process of buying and selling.”

Can markets be used to govern anything?

Firms?

Governments?

Nonprofits?

Families?

Neoliberalism

“an ideology that rests on the assumption that individualized, arms-length market exchange can serve as a metaphor for all forms of human interaction”

<https://tompepinsky.com/2013/12/04/defining-neoliberalism/>

Arguments against markets

Other institutions more effective and equitable

Repugnant markets

Repugnant markets

Stuff that shouldn't be exchanged in a market because doing so violates norms

Organs

Babies

People

Votes

Cadavers

Horse meat

Arguments against markets

Other institutions more effective and equitable

Repugnant markets

Merit goods

Merit goods

Stuff that everyone should get automatically outside of markets because of norms

Education

Security

Healthcare

Transportation

Culture

Arguments against markets

Other institutions more effective and equitable

Repugnant markets

Merit goods

Markets, trading, and prices

Arguments for markets

They are great at producing and distributing goods and services

They are great at allowing for specialization

Specialization and trade

Comparative advantage

Opportunity cost is lower than other party's

Absolute advantage

Cost is lower for one party

Gains from trade

Expanded possibilities!

Both parties can do more; allows for more growth

Fairness though...

Arguments for markets

They are great at producing and distributing goods and services

They are great at allowing for specialization

Through prices, markets send signals about scarcity

Prices are messages

“When markets work well, prices send messages about the real scarcity of goods and services”

Prices coordinate activity and behavior among complete strangers

Prices are messages



Friedrich Hayek

**We all make decisions
based on information**

Markets produce prices

Prices guide our decisions

**We don't need to know about all global
economic and political trends!**

**Prices are all someone needs to know
to take action in an economy**

Messages of what?

Prices shape what we consume

Seasonal fruit; droughts, floods, wars

**Prices shape production
and innovation**

US Civil War and cotton

McRibs, Extra Most Bestest, HFCS

**How should
prices be set?**

**What happens if prices are
systematically wrong?**

When prices do not capture the effects of individual actions, markets fail

Public goods

Externalities

Monopolies

Missing markets

Asymmetric information

Governments in the economy

Special features of governments

Only actor allowed to
use legitimate force

Only actor with
civil and human rights
obligations to its citizens

Two possible goals

Maximize surplus
(efficiency)

Ensure fairness

Yay governments

Governments can use public policy to fix inefficiency and unfairness

Incentives

Regulation

Persuasion and information

Public provision

But wait!

An organization with the
power to address
efficiency and fairness
can also do great harm

**“With great power comes
great responsibility”**

Peter Parker's Uncle Ben

Boo governments

Use of force to silence opponents

**Rent seeking, oligarchy, and
self-enrichment**

Limits of governments

Well-governed societies place
limits on government power

Elections

Constitutional restrictions

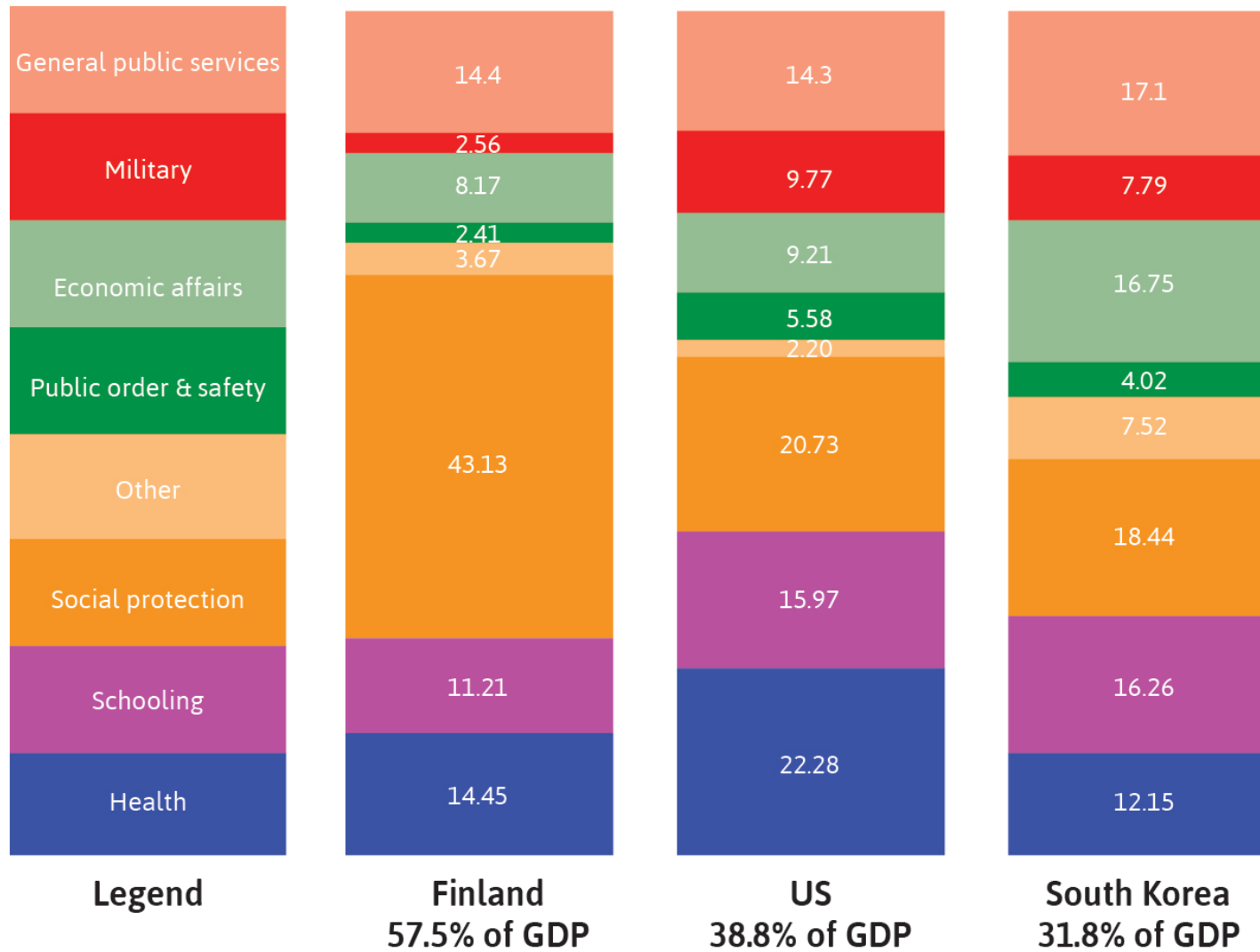
Democracy and factions

Three key democratic institutions

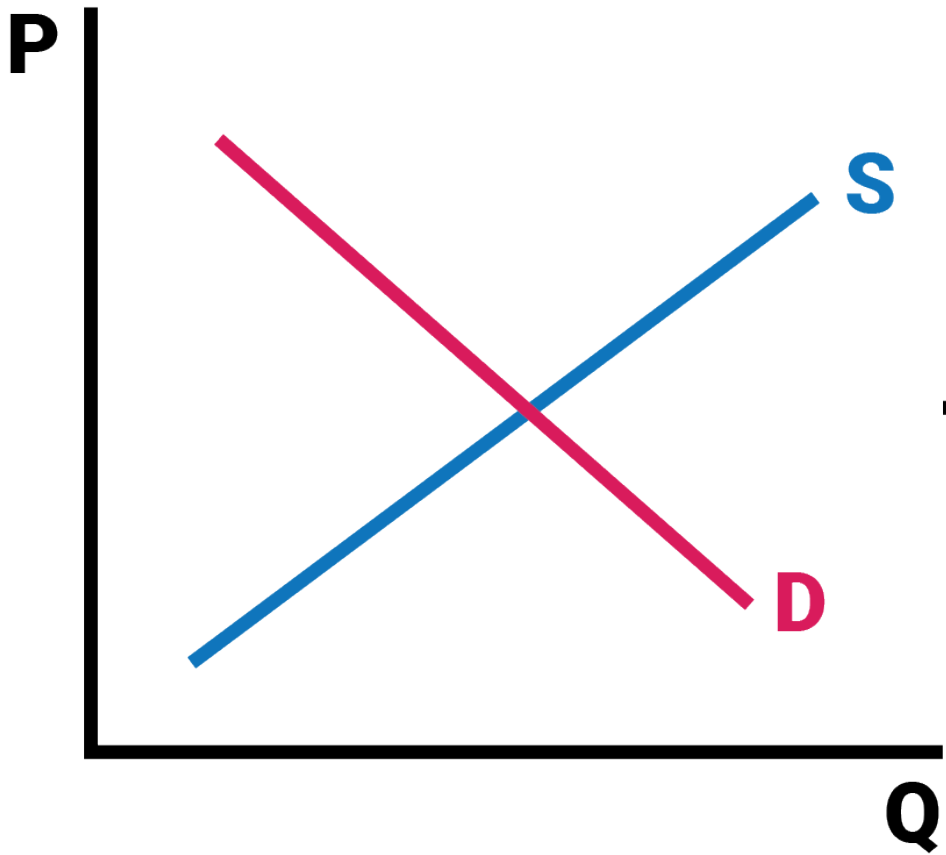
Rule of law

Civil liberties

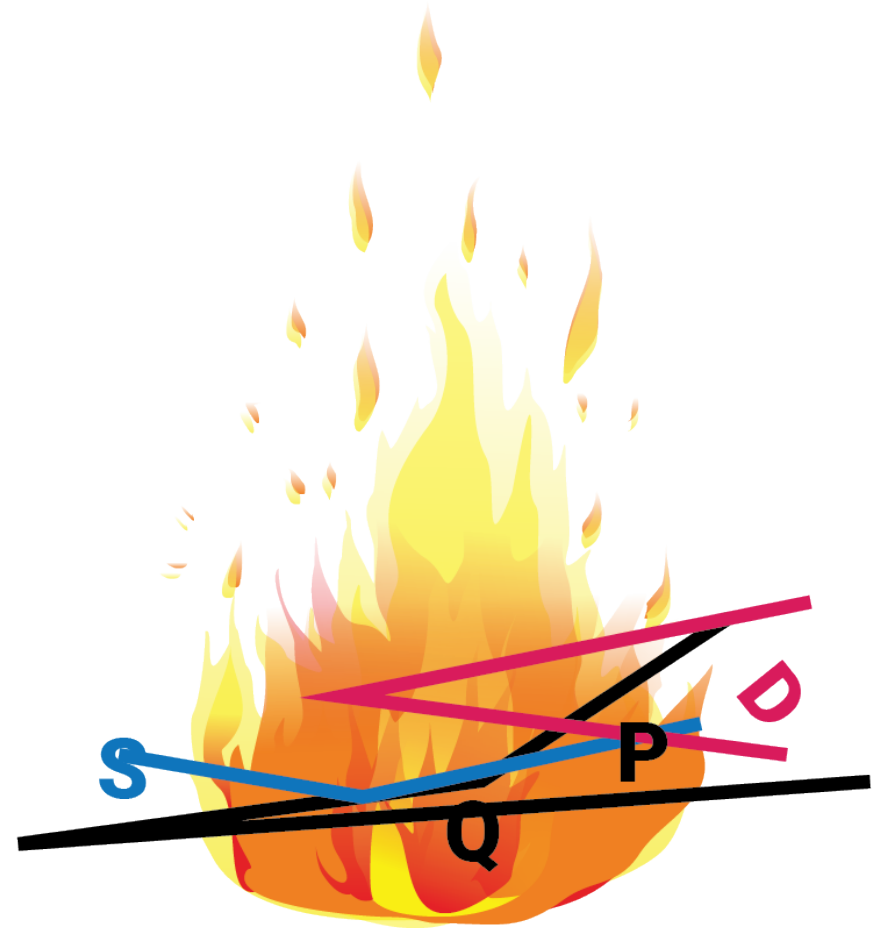
**Inclusive, free, and
decisive elections**



What makes these different?



Politics



The FEDERALIST, No. 10.

To the People of the State of New-York.

AMONG the numerous advantages promised by a well constructed Union, none deserves to be more accurately developed than its tendency to break and control the violence of faction. The friend of popular governments, never finds himself so much alarmed for their character and fate, as when he contemplates their propensity to this dangerous vice. He will not fail therefore to set a due value on any plan which, without violating the principles to which he is attached, provides a proper cure for it. The instability, injustice and confusion introduced into the public councils, have in truth been the mortal diseases under which popular governments have every where perished; as they continue to be the favorite and fruitful topics from which the adversaries to liberty derive their most specious declamations. The valuable improvements made by the American Constitutions on the popular models, both ancient and modern, cannot certainly

Factions = bad

Fix factions by removing
their causes...

...or minimizing
their effects

Bigger republic =
more competition =
better

“**Extend the sphere**, and you take in a greater variety of parties and interests; **you make it less probable that a majority of the whole will have a common motive to invade the rights of other citizens**; or if such a common motive exists, it will be more difficult for all who feel it to discover their own strength, and to act in unison with each other.”

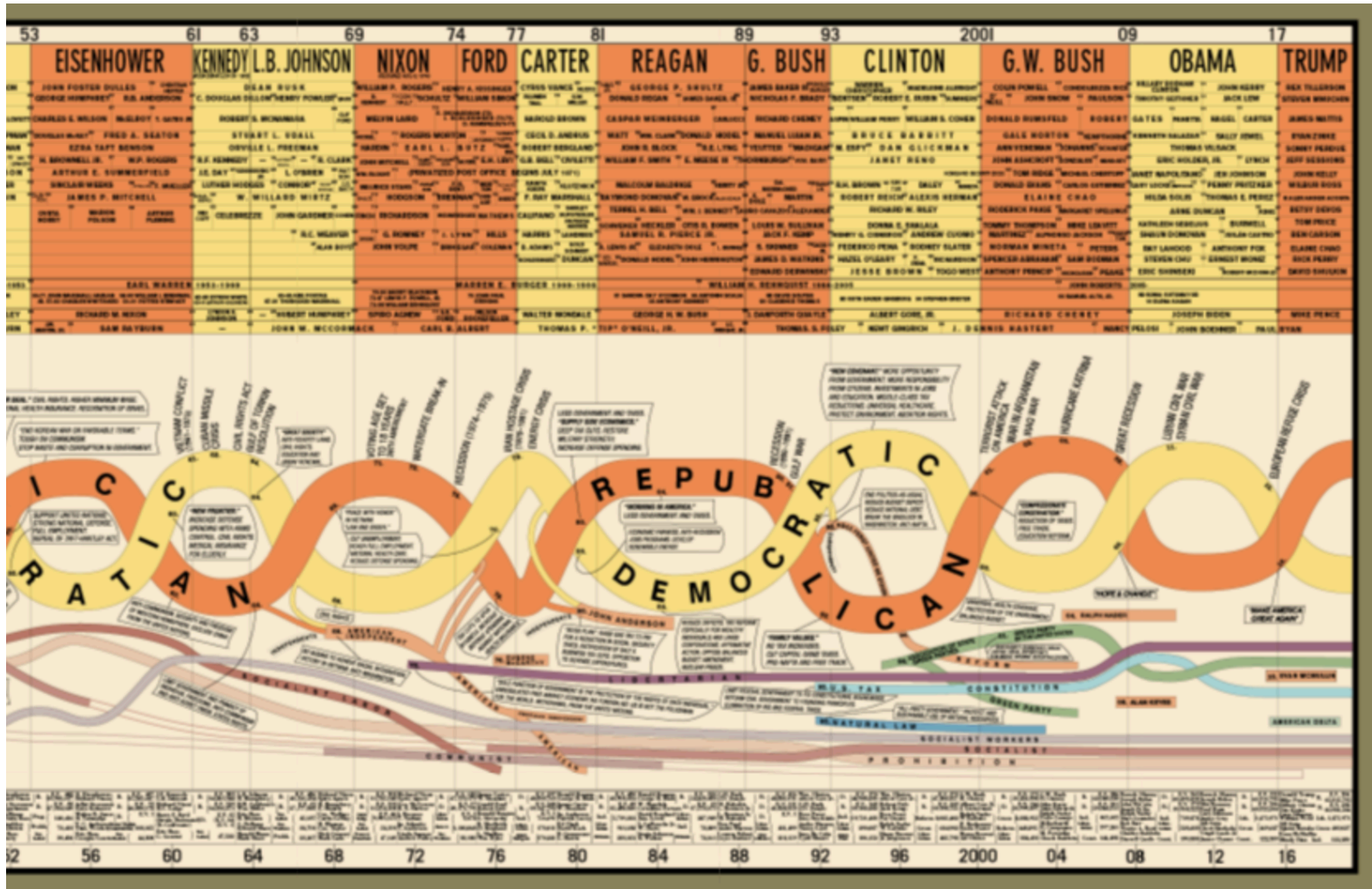
Problems with argument

Constitutional system empowers minorities; provides veto points

Pre-Bill of Rights

Assumes multiparty system

Duverger's law: plurality-rule elections + single-member districts = two parties



<https://historyshots.com/collections/political-financial>

Small factions/minorities have inordinate power in democracies because of the dynamics of small groups

CAVEAT: Minorities ≠ marginalized groups

Minorities with access to political system have inordinate power

Better term = interest groups

Small factions and public goods

Why do we need factions?

“[I]ndividual, unorganized action will either not be able to advance that common interest at all, or will not be able to advance that interest adequately”

Mancur Olson, *The Logic of Collective Action*, p. 7

“Never doubt that a small group of thoughtful, committed, citizens can change the world. Indeed, it is the only thing that ever has.”

Margaret Mead

**Have you ever contributed to or
volunteered in a national
political campaign?**

Why did you donate or volunteer?

How much did you benefit personally from that
donation or from the outcome?

How much did the group
benefit from your work?

Individual gains in large groups are essentially zero

Why would a rational, self-interested person donate to a national campaign or join a union or support activist causes?

Group interests = public goods

“The achievement of any common goal or the satisfaction of any common interest means that a public or collective good has been provided for that group”

Mancur Olson, *The Logic of Collective Action*, p. 15

Free riding!

**Have you ever contributed to
a city-level (or lower!)
political campaign?**

**Have you tackled a single
issue with a city council?**

You get individual benefits if you believe your individual actions will lead to actual change

Small groups can harness this

Benefits can be excludable

Little free riding = more power

(Madison was right!)

**How do large groups
stop free riding?**

Change individual calculus

Coercion

Increase the costs of not acting

Selective incentives

Increase the benefits of acting

<https://benefits.nra.org/>

Federation

Make big group feel small

Moral of the story

Small groups can be too powerful

Madison's solution = use big groups

**The larger the group, the less it
will further common interests**

oh no

Concentrated interest groups vs. large latent groups

Narrow special interests and passionate small groups exert enormous influence on policy

Large groups of concerned citizens (even if passionate!) are stuck with free riders

**Is it okay that small groups
wield substantial power?**

What can we do about it?
(or should we do anything about it?)

What does this mean for democracy?

**What does this mean for public
administration and policy?**

Government failure

Failures

Market failure

Prices don't reflect individual actions

Government failure

Failure of political accountability



“With great ability comes great accountability”

Miles Morales’s father, Jefferson Davis

Government failures

Failure of government accountability

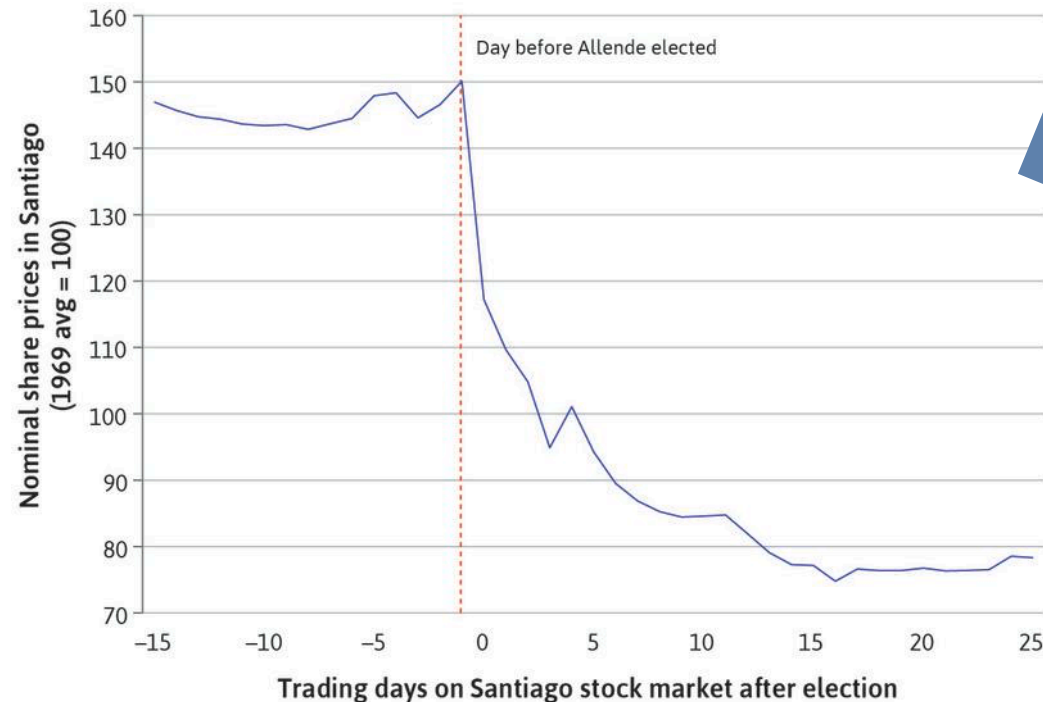
Economic infeasibility

Administrative infeasibility

Political infeasibility

Economic infeasibility

Public policy must be a Nash equilibrium to be successful



Way more on this in the next few sessions!

Administrative feasibility

A policy might be adopted if there's not enough state capacity

Limited information

Limited capacity

(This is why you're here!)

Political feasibility

A policy might not be adopted even if it's great and there's sufficient state capacity

Short-termism

Unequal access

Voting

Political feasibility

Short-termism

Implement policies that get you elected next cycle

Political feasibility

Unequal access

The rich can have
a louder voice

Smaller groups can
have a louder voice

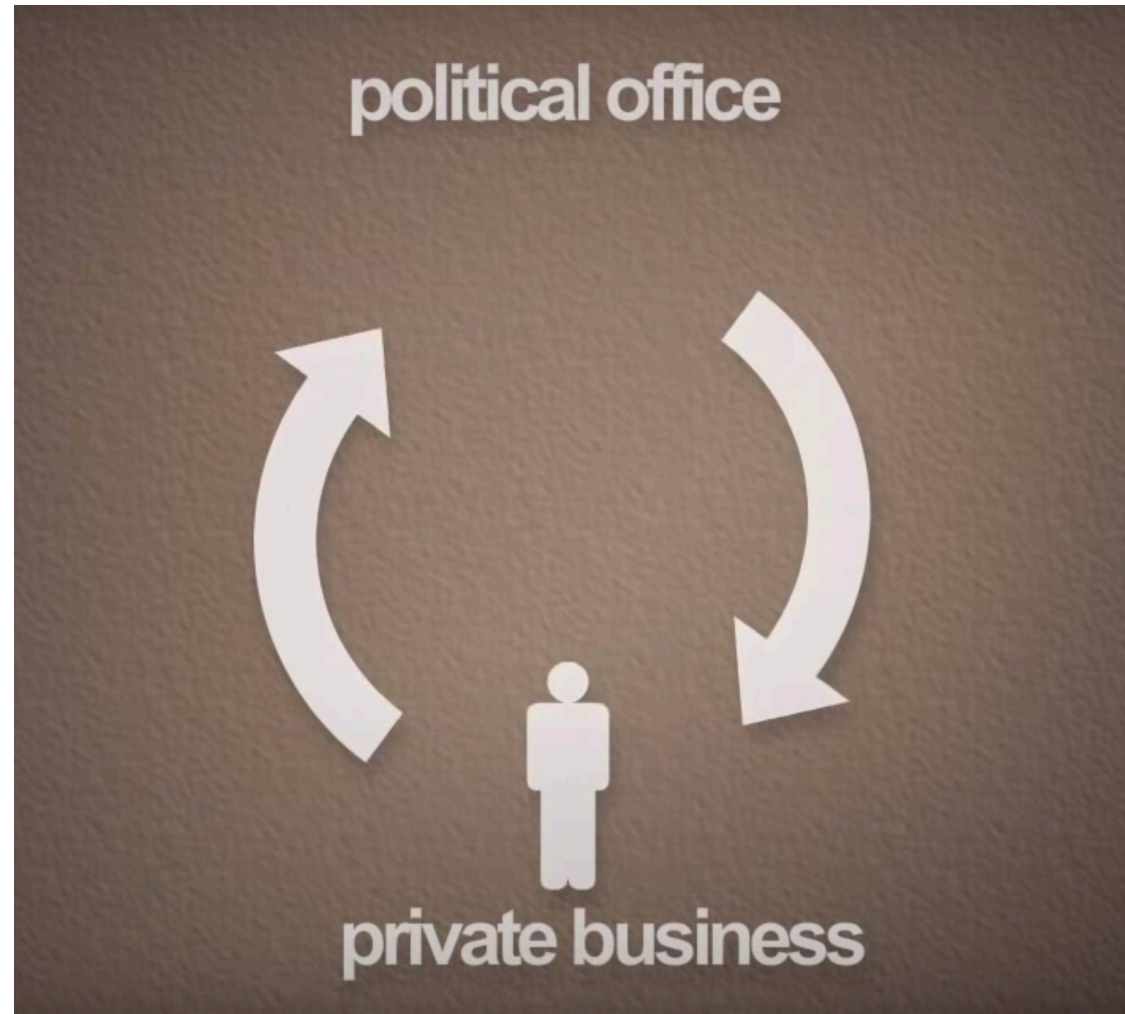




1960

TODAY

Lobbyists





John Boehner ✓

@SpeakerBoehner

Follow



I'm joining the board of [#AcreageHoldings](#) because my thinking on cannabis has evolved. I'm convinced de-scheduling the drug is needed so we can do research, help our veterans, and reverse the opioid epidemic ravaging our communities.

[@AcreageCannabis](#)



News Release: Board of Advisors Appointment

acreageholdings.com

4:58 AM - 11 Apr 2018

    **Filing Taxes Could Be Free and Simple. But H&R Block and Intuit Are Still Lobbying Against It.**



The makers of TurboTax and other online systems spent millions lobbying last year, much of it directed toward a bill that would permanently bar the government from offering taxpayers prefilled filings.



by **Jessica Huseman**, March 20, 2017, 1:22 p.m. EDT



GUTTING THE IRS

Congress Is About to Ban the Government From Offering Free Online Tax Filing. Thank TurboTax.

A bill supported by Democrats and Republicans would make permanent a program that bars the IRS from ever developing its own online tax filing service.

by Justin Elliott, April 9, 5 a.m. EDT



GUTTING THE IRS

Congress Is About to Gut Government From Online Tax Filing

A bill supported by Democrats and Republicans would create a program that bars the IRS from ever

by Justin Elliott, April 9, 5 a.m. EDT

Those efforts have been fueled by hefty lobbying spending and campaign contributions by the industry. Intuit and H&R Block last year poured a combined \$6.6 million into lobbying related to the IRS filing deal and other issues. Neal, who became Ways and Means chair this year after Democrats took control of the House, received \$16,000 in contributions from Intuit and H&R Block in the last two election cycles.

Who are politicians responsive to?



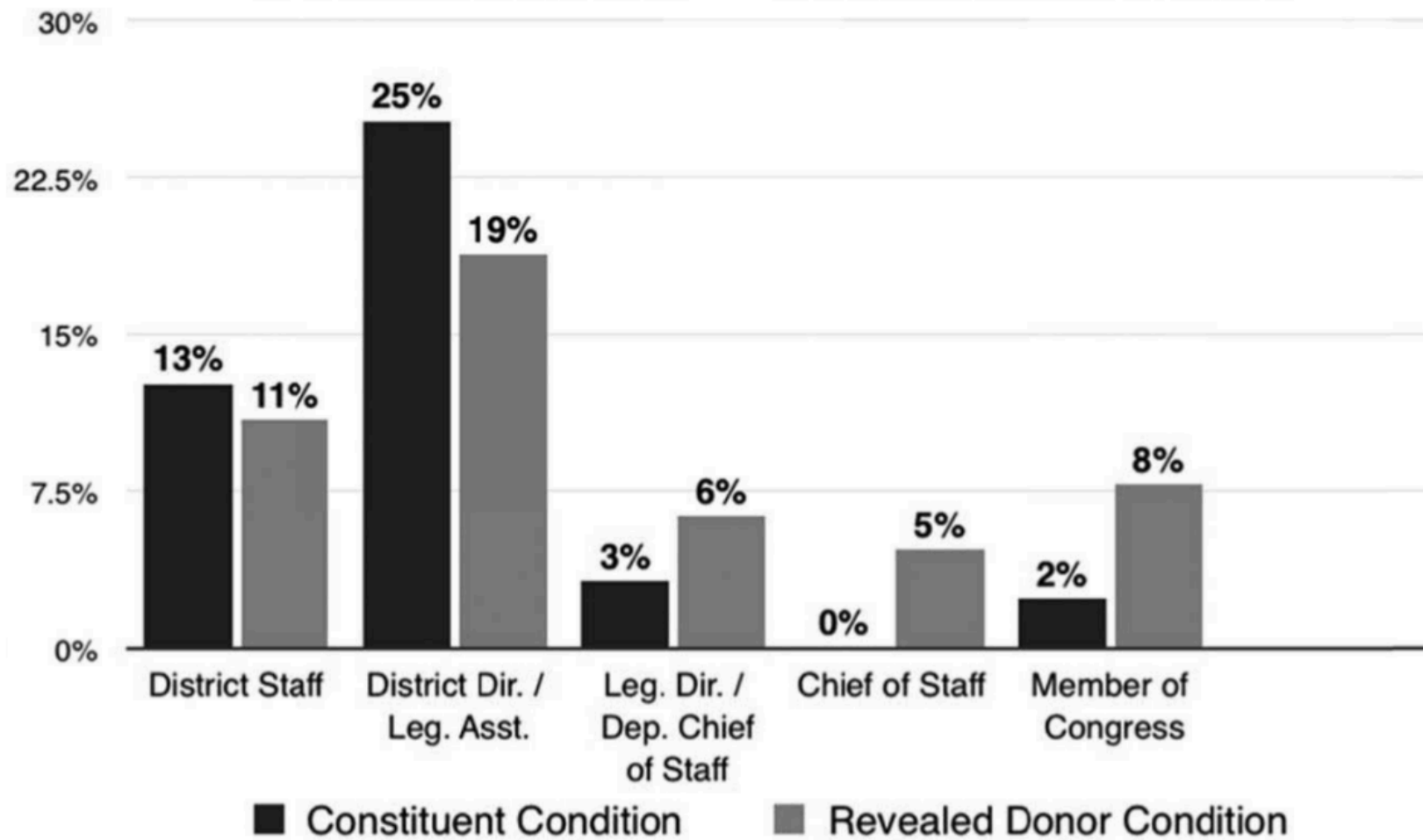
Campaign Contributions Facilitate Access to Congressional Officials: A Randomized Field Experiment

Joshua L. Kalla University of California, Berkeley

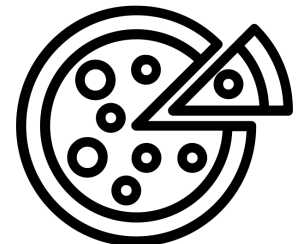
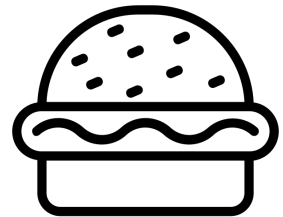
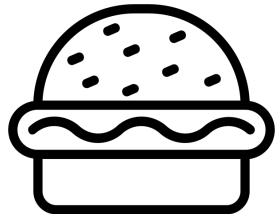
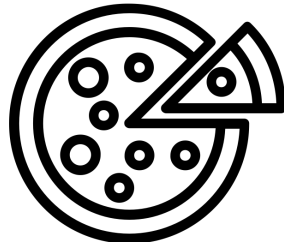
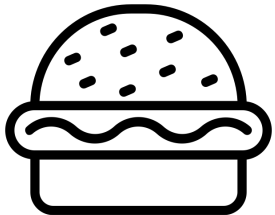
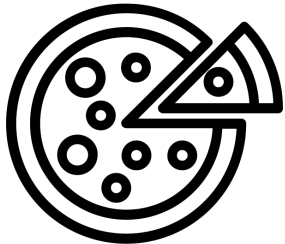
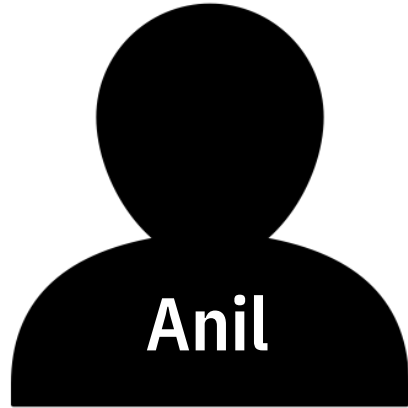
David E. Broockman University of California, Berkeley

Concern that donations to political campaigns secure preferential treatment from policy makers has long occupied judges, scholars, and the public. However, the effects of contributions on policy makers' behavior are notoriously difficult to assess. We present the first randomized field experiment on the topic. The experiment focuses on whether contributions facilitate access to influential policy makers. In the experiment, a political organization attempted to schedule meetings between 191 congressional offices and the organization's members in their districts who were campaign donors. However, the organization randomly assigned whether it revealed to congressional offices that prospective attendees had contributed to campaigns. When informed prospective attendees were political donors, senior policy makers made themselves available between three and four times more often. These findings underscore concerns about the Supreme Court's recent decisions deregulating campaign finance.

FIGURE 1 Access Gained to Congressional Staffers, by Experimental Condition



Voting



Voting

Pizza > Burger

Burger > Soup

Soup > Pizza

Condorcet paradox

Vote intransitivity

Voting

Order of voting matters!

Speaker of the House

(or whoever's in charge of the agenda)

**could theoretically
guarantee any outcome**