

The Use of Knowledge about Society

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Abstract: Selection of efficient institutions or policies in politics requires constituents to possess data on the net benefits of forgone political alternatives. Political competition fails to inform agents of data they need to estimate alternative political strategies aimed at institutional establishment or reform. Political choice is more complex than private choice, yet political competition fails to inform agents of 'political costs' as do market prices, with respect to private choice. This prevents the adoption of efficient institutions. The empirical record supports this contention.

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I Transition and Knowledge

The inability of nations to converge on institutions that promote economic efficiency raises doubts about the efficiency of political reform. Chicago Public Choice theorists argue that efficient institutions and policies displace inefficient ones over time, especially within a democratic framework¹. This ‘Efficient Politics Hypothesis’ predicts convergence on institutions that promote efficiency, yet this prediction clearly fails². Virginia Public Choice theorists argue that inefficient policies and institutions persist because of political failure³. This does not explain non-convergence either. General propositions about politics predict relatively uniform results across nations, but results vary greatly between nations. For instance, democracies like the UK and India and dictatorships like North and South Korea experience widely divergent results⁴. Furthermore, dire conditions persist in many nations for vast periods. De Soto (2003) connects the poverty of less developed nations with the absence of impersonal rule of law. The fact that efficient legal institutions have not emerged in civilizations like Egypt, *after thousands of years*, contradicts the idea that such institutions emerge spontaneously via political competition. The additional fact that people in such

¹ Stigler (1992) argues that people will not tolerate inefficient institutions or policies, so the test of time proves efficiency. Becker (1983, 1976) argues that democratic competition favors efficient policies and minimizes dead weight losses. Low cost methods of wealth transference garner stronger political support, so policies that persist do so for good reasons. To Wittman (1995 p.193), “democratic governments maximize wealth by allocating those tasks to economic markets at which they are most efficient”. Breton (1989) claims that since ‘goods are goods’, private versus public sector supply depends upon comparative advantage.

² See Olson (1996) and Knack (1996) for discussion of these issues.

³ Congleton (2001a) argues that electoral competition moderates rational ignorance, but genuine policy errors still occur. To Olson (2000) special interests prevent the Coase Theorem from applying to politics. Besley and Coate (1998) contend that commitment problems prevent the adoption of Pareto improving investment. Stiglitz (1998) claims that incentives in government for secrecy exacerbate political failure. Lott (1997a) derides arguments for Political Efficiency as ‘possibility theorems’ that lack empirical proof. Rowley (1997) argues that complexities and indivisibilities in politics indicate inefficiency. Coate and Morris (1995) claim that difficulties in discerning the effects of actual policies and the preferences of politicians promote inefficient policies.

⁴ One could argue that India already has British institutions. But India’s state plays a larger economic role than in the UK. To Lott (1997b) these discrepancies exist because variations in local political conditions alter the effects of policies. With elastic support for policies, banning low cost methods of effecting transfers increases total wealth. This does *not* explain differences in both institutions and performance. If differing conditions require regional variations in institutions for efficiency, then different institutions could result in similar economic performance, and similar institutions may produce different results.

nations have also failed to learn from centuries of success in the West indicates serious problems with deliberate planning of political reform.

This paper argues that political competition delivers widely varying and frequently poor results because constituents lack data on the *political opportunity costs* of institutional reform. Political opportunity costs are the net present value of the next best alternative political strategy, to a constituent. Within existing political institutions they select political strategies (voting or lobbying) that establish or alter public institutions through reform, and alter private institutions through intervention. By choosing particular strategies, constituents forgo others and their results⁵. They must possess data on the net present values (including transition costs) of their best alternatives to choose based on informed expectations⁶. The collective, coercive, emergent, and complex, nature of politics prevents constituents from obtaining this data. This paper accepts the idea that scholars can attain *academic goals* in analyzing politics. It disputes the idea that individuals can possess the data they need to attain *practical goals* via politics. That is, constituents lack data indispensable for cost minimizing utilitarian political calculations pertaining to institutional choice and public policy.

The first part of this paper argues that political competition leaves constituents ignorant regarding profitable reforms. This is due to the immense complexity of political choice and the lack of an effective means reckoning political alternatives in terms of something

⁵ This paper does not concern the aggregation of preferences for final public goods and services. It questions the ability of individuals to weigh the value of creating or altering public or social institutions that deliver such goods, or of altering private institutions through public policy.

⁶ Public Choice analyses focus on the search for information within existing institutional arrangements. Downs argues that voters seek information (1957 p 208), and ways of reducing information costs (p 237), but discount the value of this information given their influence on political outcomes (p 258). Fiorina (1981) contends that citizens can evaluate the performance of incumbents by simply calculating changes in their own welfare. Peltzman (1990) contends that voting works as an efficient aggregator of information. Popkin (1993 p. 17-18) claims that voters can use personal financial transactions and 'informational shortcuts' such as expert advice and party labels to reduce information costs (ibid p 20-25). Wittman (1995, pp 10-12) notes that political organizations and candidates provide information at little costs to voters. Voters are therefore better informed than often thought to be and can also make "informed judgments" with little information. By focusing on actual political processes, they ignore the issue of estimating institutional opportunity costs.

equivalent to market prices. A-priori theorizing fails to inform constituents of political opportunity costs. Deficiencies in empirical data prevent the “a-posteriori” calculation of these costs. This refers to uncertainty, as discussed by Knight (1921) Keynes (1937) and Shackle (1938, 1958), rather than imperfect information or biased expectations⁷. The second part critiques Chicago Public Choice theory. The final part considers the merits of private and public institutions given the arguments of this paper.

Informed Expectations

Efficient equilibrium exists when individuals execute plans using mutually consistent expectations (Hayek 1948a). Fremling and Lott (1996) argue that Rational Expectations theory examines misestimation of known relationships that may cancel out. They argue that problems in identifying correct *linear* relations between variables causes underestimation of true relationships, and these errors do not cancel⁸. Individuals must also account for possible non-linear relations, as well as variations in these relations through time. Accounting for 2nd or 3rd order and temporal changes in the identification phase of expectations formation compounds this problem. This paper examines such identification problems concerning the connections between political reform and personal welfare, as compared to private choice.

Individuals form expectations for private decisions in voluntary trade, and for social decisions through voting or lobbying. Within markets, consumers introspect for data on their preferences and use market prices and direct observation to estimate costs. Preferences may depend upon skills that develop with experience (Stigler and Becker 1977). Consumers each have the best insights as to likely patterns of change in these skills. Consumption often

⁷ Congleton (2001b) distinguishes between finite sampling and ignorance conceptions of incomplete data. The former pertains to the precision of probability estimations within a given domain. The latter pertains to the domain over which we define probabilities. Agents may not be aware that some opportunities exist when the domain is undefined or incomplete information. This results in uncertainty instead of risk.

⁸ They calculate that with only six variables there are over one billion possible sets of linear causal connections. The possibility of non-linear relations multiplies this greatly. Accounting for how opposing agents choose strategies that affect the expected magnitude of different causal relations complicates matters further.

entails little strategic interaction among individuals, so we need not always anticipate responses to our actions⁹.

Private acts of consumption pertain to a particular type of satisfaction for one or a few, over a relatively fixed point and span of time. Aside from sports and games, the length of and point in time for consumption does not affect either our preferences or our knowledge of them. Rational consumer choice requires data on marginal rates of substitution when relative prices change. Individuals face initial uncertainty concerning such new situations, but each has the best insights on relevant patterns of change and the ability to learn.

Demand for any particular good derives from the processes that satisfy them (Hayek 1961). Experience with new goods reveals marginal rates of substitution, and dispels initial uncertainties. Apart from status seeking, the preferences of others enter private consumer choices via scarcity constraints. Prices convey data regarding the relative rates of exchange that others will accept, given their preferences and incomes (Hayek 1948b). Consumers use this data in iterative processes by which they reject some consumption alternatives for preferred alternatives. Provided that the price system operates efficiently, consumers can best use available data to move towards preferred consumption alternatives.

Entrepreneurial choice is complex, but the profit motive prompts entrepreneurs to delete inferior business strategies and move towards efficiency (Alchian 1950, 1963). Acquisition of useful knowledge takes place *within a given set of social institutions* (i.e. markets, property, and money) that emerge out of private trading. Private competition is an iterative process through which individuals acquire data and move towards efficient equilibrium (Hayek 1948c). Market prices serve as a basis for accessing data from other minds. Does political competition provide a comparable means for people to account for costs?

⁹ Consumers may compete for social status, but such interaction typically has a limited scale. In instances where agents interact in consuming (i.e. sports and games) well-defined rules foster predictability.

Constituents minimize political opportunity costs only when they have data on the results of reforms that will each place them in a different social context. The Chicago-Virginia debate centers on optimality conditions in politics, given data that constituents can access regardless of their institutional environment, and on transition costs. This literature focuses heavily on how politicians learn about the opinions of constituents, and how constituents learn about political platforms. Both sides *assume* that these opinions concerning the results of different institutional contexts derive from data existing separate from any particular context. Instead of assuming that all data exists in a discernable form independent of the contexts that generate them, we should demonstrate this proposition, or reject it.

Tabula Rasa

The fact that individuals never experience forgone options makes all estimates of opportunity costs speculative, but in politics such estimation entails unique difficulties. Purely theoretical exercises can identify flaws in institutions, but not their magnitude. Also, such exercises often reveal opposing effects that require data to discern qualitative results.

The social nature of political choice makes varied preferences of many minds relevant to each decision. The emergent nature of political preferences makes a-priori understanding of these preferences impossible. Political competition reconciles the plans of constituents, based upon their initial preferences¹⁰. Political preferences derive from ideological beliefs concerning collective goals and individual rights, and exist in many forms¹¹. Upon entering politics, constituents perceive existing political states, imagine better states, and consider alternative means of improving their condition¹². Each begins with a distinct ideological or

¹⁰ Competition reveals data initially dispersed among many minds, and thus always entails surprising results (Hayek 1978, O'Driscoll and Rizzo (1985). This holds true in politics as constituents mutually adjust their plans.

¹¹ As Stigler (1992 p 459) notes, "Maximum national income, however, is not the only goal of our nation".

¹² Mises [(1997 (1949))] discusses this as a general proposition. Kirzner (1985) hints at how people discover alternative political means to more desired states when he mentions that politics leads to a different kind of discovery. He and like-minded theorists focus on how political processes hinder discovery in markets- see

philosophic conception of what rights should be, and even of what policies and rights currently exist by statute¹³. The diverse and social nature of these preferences prevents agents from using introspection to gather needed data a-priori.

The evolving nature of these preferences poses severe problems for a-priori analysis of costs. Political competition informs constituents about the viability of their own position, as well as of alternative beliefs. Demand for goods in markets derives from experience in satisfying fundamental consumer desires. In politics experience determines not only particular institutions and policies, but also the fundamental rational behind them. Nearly all constituents acquire preferences for particular policies by adopting systems of belief that emerged out of debate¹⁴. Constituents therefore initially lack data on their own fundamental preferences, and will never know if this data is complete¹⁵. The collective nature of political choice makes discerning relevant preferences more difficult than for private choice.

Preferences concerning private decisions may change or become clearer through experience, but each have the best insights into likely patterns for these changes. Since constituents make each political decision for many, iteration concerning preferences will take place between many minds, rather than within individual minds. Constituents are far less able to predict likely patterns of change for minds other than their own, so they possess less data on patterns of change in preferences as compared to private choice.

The collective nature of politics makes it difficult to predict reactions to alternative strategies. The sale of a private good denies that exact good to other consumers. Further supply of that or a similar good abates frustration over such denials. When some choose for an entire constituency, they confound the efforts not of those who want the same thing, but

O'Driscoll and Rizzo (p. 141), Ikeda (1997 p209), and Wohlgemuth (2002). Alternatively Lavoie (1985) and Buchanan (1982) claim that competition in each system reveals unique data that are particular to that system.

¹³ Schumpeter (1950 p 263) mentions that political opinion formation is similar to commercial advertising.

¹⁴ Only a few (i.e. Marx or Locke) played a significant role in developing their own political preferences.

¹⁵ As Hayek (1960) notes, the mind cannot predict its own advance.

of those who want something else. They deny others the institutions or policies that they currently believe that they want. This induces far more intense and complex reactions because it forces some to endure undesirable results¹⁶. This complicates estimates of transition costs greatly. Strategic maneuvering leads some to falsify their preferences. Such false signals complicate the identification of trends in patterns of behavior greatly. Constituents must anticipate patterns in falsification under alternative institutions to adjust their predictions of the formation of true preferences and related strategies.

Prior to entering politics, constituents will be ignorant of the strategies and interests, of their opponents, and even of their allies and initially disinterested parties. *They will not even initially know who their opponents and allies are.* Even if they have some notion as to how their own skills and strategies will develop, they cannot anticipate the development of other minds¹⁷. They therefore lack a-priori knowledge of the outcomes of strategic interaction even if they have full information on all *initial* political preferences. Constituents cannot use introspection in ex ante estimates of transition costs precisely because the process of political competition itself reveals data on both political preferences and strategies¹⁸.

Constituents also discount returns from political action according to expected lags in realizing results. The reactions of opponents and allies will hinder or propel reform. This alters the present value of these returns. Private inter-temporal decisions require predictions of how others will react, but are less complex in terms of discerning time preferences for the relevant decision makers. Private agents require data on the discount rates of partners or stockholders, but can self select into ownership forms that minimize these burdens. The collective and coercive nature of politics places greater demands on constituents to discern

¹⁶ There is a serious difference between failure to secure one good, and being forced to consume another good.

¹⁷ That is, it is completely absurd to say that the mind can predict how other minds will advance.

¹⁸ Schumpeter (1950 p 286) argues that the 'tremendous loss of energy' from incessant legislative battles impairs democracy. This overlooks the importance of discovery via competition. These 'incessant battles' reveal important data on prevailing political conditions.

the intentions of associates. High switching costs between constituencies often make self-selection by constituents less viable, and conflicts more likely. Thus greater problems in acquiring data on discount rates exist in politics. Also, time preference may depend upon personal ethics¹⁹. If political competition alters our ethical beliefs, underlying time preferences can change through the course of it.

While relatively predictable and communicable data drive *private* decisions, political decisions hinge upon immensely complex data for *social* choices that get shaped within and by the processes that reveal them. Ikeda (1997 p81) argues that government responds to changing political conditions slowly. This might be so, but true costs depend on conditions that would have developed under alternative conditions. Efficiency of politics in revealing *actual* political conditions indicates ignorance of the same data on *forgone* political conditions. The inability of constituents to see into other minds renders them ignorant of how patterns in equilibrating, but sequential, changes will emerge under alternative institutions. More often than not theory raises possibilities depending upon unique conditions of place and time. Theory can at best deliver *ordinal* rankings of political alternatives. Varying underlying conditions make even such ordinal rankings imprecise, and constituents need *cardinal* measurements of reasonable accuracy if they are to account for underlying political costs. Since they can neither envisage nor experience actual forgone political alternatives, we must consider if they can discern these costs from history.

Historical Experience

Scholars possess much empirical data on the performance of institutions²⁰. Does this provide constituents enough of the right quality and type of data to estimate true political

¹⁹ Hazlitt [1998 (1973)] argues that ethical choices center on the willingness to forgo short term gains for the longer term good.

²⁰ For example, see Pitlick (2002), Gwartney, Lawson, and Holcombe (1999) or Haan and Siermann (1998)

costs? Can constituents apply this data in practice? Can they use data on different institutions in different places at the same time, or in the same place in different times, or in different places and times, as 'prices' to account for political opportunity costs?

In markets, prices adjust through trial and error, and serve to inform individuals of costs. Search costs leave individuals rationally ignorant of some data concerning gains from trade (Stigler 1961). Political choice entails greater difficulties. Statistical data is highly aggregated and largely in pecuniary form, so there are often several plausible interpretations specific underlying conditions for any specific prices²¹. The use of historical data in making political decisions about the future choice requires constituents to both discern the causal connections between specific institutions and policies with real changes in welfare and to adjust this data for differences in underlying conditions between the past and the future.

Our ability to use statistics to identify patterns in social interaction decreases as the complexity of the phenomena we examine increases (Hayek 1967a pp26-31). To be tractable, statistics identify trends in classes of elements within complex systems, but ignore individual elements (ibid p29). The complexity of politics makes this problem worse than in markets.

Comparisons between different local institutions reveal data on political preferences. Vihanto (1992) argues that competition between local governments leads to surprising discoveries of preferences for local public goods. Inter-jurisdictional competition spurs the realization of innovations that reduce failures in the supply these goods. Competition makes comparisons between different localities possible, but are such comparisons relevant?

The relevant comparison is between the outcome of the political process in a given political jurisdiction and the outcome that would have obtained under an alternative institutional regime. Constituents can use the historical experiences of others if these

²¹ Transaction costs prevent the use of prices as exact measures of value (Buchanan 1969 p 85).

experiences approximate the outcomes that would result from their own political actions, and to the extent that they can perceive such approximations. They must adjust for differences between historical circumstances and those that they will face, if they can.

Results between constituencies may vary because of differences in underlying conditions²². Failures in East European reforms might derive from ideological differences between East and West, weak but essential political skills, or varying discount rates.

Constituents must disaggregate data correctly to see links between individual institutions and overall economic results, but this is difficult. Many factors affect economic performance in any constituency. Different constituencies often have similarities that make comparisons difficult. Since different polities have differences in institutions and other factors, ambiguity in these causal connections misleads constituents in their political calculations²³. We also lack sound data for most of history, particularly with underground elements of the economy, and related institutions²⁴. Also, statistical data from most time periods is at best meager²⁵.

The migration of factors from one polity to another indicates that the former has inferior institutions (Olson 1996). However, by driving out high productivity workers, these nations exaggerate the performance of ones with better institutions. Also, trade barriers benefit narrow interests, but limit specialization and division of labor. This will affect labor productivity by limiting opportunities for innovation in labor skills, and related technology. Strategic maneuvering introduces more ambiguity into these comparisons, as constituents

²² Differences in the political skills and goals of politicians and the political skills, time preferences, and philosophic or religious beliefs of different constituencies introduce ambiguity in to the historical record concerning institutional alternatives and observed results.

²³ Chang (1998) argues that failure to satisfy local demands for redistribution may lead to political unrest that deters investment and slows development. Of course, such pacification may also lead investors to anticipate future takings of their own holdings. This paper is interesting because Chang emphasizes that Westerners ignore local political conditions in Asian nations. Local differences call for unique institutions, but how are constituents to know when foreign examples apply to their own situation?

²⁴ Boettke (1993) discusses how black market transactions, corruption, and special privileges enabled the Soviet economy to function to some extent, despite fundamental flaws in official economic arrangements.

²⁵ For example, Fogel and Engerman (1995) use scant available data to estimate the 'wages' of slaves.

must predict alternate trajectories for individual strategies under different institutions. Interregional comparisons inform constituents about the merits of reform only if they can adjust for how social interaction and innovation would evolve under alternative conditions.

Even if constituents adjust all of these factors, local competition between alternative institutions conceals potential benefits of greater institutional uniformity. Extended provision of public goods may entail surprising scale economies, diseconomies, or network externalities. Extended programs may limit free riding on public goods or increase collective action and principal-agent problems in policy and the bureaucracy. Experience may also reveal ways of minimizing the administrative costs of such arrangements. Of course, the imposition of such uniformity may bring about greater rent seeking and diseconomies. Estimates of the *magnitudes* of the net benefits or losses to reforms that extend the scope of institutions come with experience. Situations where different areas do or do not have different institutions *are themselves* unique institutional orders that generates particular results.

Conversely, situations where secession and expulsion exist as viable options will reduce rent seeking and diseconomies. The existence of such options may generate these results without causing actual fragmentation of existing constituencies. Depending upon how political competition plays out under these rules, the strategies that proponents and opponents apply to such a regime may or may not be optimal. Since secession and expulsion differ in terms of which parties must act to form new political institutions, the choice between these two approaches to freer political exit will also lead to unique results.

Interregional competition between institutional alternatives differs when trade and migration do and do not occur, and from interregional uniformity. Constituents never experience particular institutions at local, national, multinational, and global levels concurrently. Nor can they experience both strong commitment and free exit at any of these

levels simultaneously. Constituents must also adjust for how the duration of institutions affects their performance. Frequent changes in institutions reveal data on their many forms. But such changes will induce unique strategic behavior to nullify said action. This hides data on the performance of different institutions, and instead informs agents on the transition costs that fall out of how constituents anticipate and adjust to institutional change.

Constituents need a stable and lasting institutional environment to learn how different institutions perform. Small differences in growth rates lead to large differences in living standards as time passes. These rates depend upon innovations and time preferences from others, so small errors in ex ante estimates of the affects of institutions on the determinants of growth will lead to large errors in estimates of associated long term welfare benefits²⁶.

Institutional longevity hides data on transition costs and limits the number of institutional orders about which we can learn. Structural changes also complicate such comparisons across time. By comparing institutions in the same place but at different times we eliminate the need to adjust for trade and migration between the constituencies in question. But, differences in underlying conditions will likely multiply. Coexisting societies have access to the same technology, but societies in different time periods will have real differences in this, and other, factors. Preferences and ideology will differ. These are not the same people. Such factors may not remain stable across time in a single area- even if there is little migration²⁷. Comparisons of different places at different times entail additional interregional problems that make them less useful in estimating political opportunity costs.

²⁶ Constituents face particularly difficult problems if agents account for the welfare of future generations. Parfit (1986) argues that policy changes affect the pattern of human reproduction. To account for intergenerational welfare, agents must form expectations the strategies, innovations, and welfare for those who *would be born* under alternative paths of institutional evolution. Thus, data on parental preferences and genetic potential may be relevant to political calculations. This 'non identity problem' exists even if constituents discount the welfare of future generations completely. The affect of birth-death on Social Security illustrates how changes in the pattern of human reproduction can affect those with long life expectancies.

²⁷ As already noted, migration between time periods is impossible, but migration through time can alter underlying conditions and render comparisons across time invalid.

Each possible order delivers unique results, so comparisons between political alternatives require data adjustments for changes in skills, scale, duration, strategic interaction, migration, ideological beliefs, and differences between the initial underlying conditions of history and those of the present. Not only are there problems in identifying causal connections in past data, constituents lack data on differences in patterns of change between alternatives.

Observed disparities in economic performance exist due to variations in past political conditions and errors. Agents must account for past errors to avoid future errors. That is, they cannot assume that the experience of others reflects underlying conditions alone. Even if underlying conditions permit comparisons between different areas, the fact remains that some interests will lie dormant not because costs prohibit political action, but merely because they are ignorant of the possibilities that await them in the political realm. By establishing the existence of ignorance as a source of error with the preceding arguments, we introduce an additional problem in adjusting data on political opportunity costs.

Discovery can also increase perceived uncertainty by demonstrating that the world is more complex than previously believed²⁸. If constituents do not recognize that their data is incomplete, then their ignorance increases further. There is also no reason to assume that we have experience with optimal institutions. History tells us *nothing* about future innovations.

Changes in patterns of equilibrating, but sequential, adjustments in our plans evolve differently under different institutions. Unless these patterns are identical under all institutions, the use of historical data to estimate political opportunity costs will require constituents to perform numerous complex adjustments. In some instances, patterns may evolve in a similar fashion thus negating the need for these adjustments. But, constituents only know *if* these patterns do or do not change through experience, or by ‘introspecting’

²⁸ Hayek (1967a p39) uses argument from Karl Popper’s *On the Sources of Knowledge and Ignorance* (1960)

into minds other than their own²⁹. Market prices substitute for direct insight into other minds concerning marginal costs. Politics lacks a comparable means of conveying such data.

History provides data on expressed preferences and actual strategies and skills of *past* individuals under *prior* circumstances. Private agents decide between well-known alternatives according to stable or predictable preferences. The relative simplicity and privacy of such choices make ex ante speculation and the use of personal history viable means to estimate alternatives. When constituents make political choices, they do so within existing institutions, using data compiled within that context, and concerning interaction within that context.

Each historical episode produces results that derive from specific preferences, strategies, abilities, technologies, and errors- all within particular institutions and over a particular time spans. Since each historical episode is unique, and constituents know little of how, when, or if they should adjust historical data to use in weighing political alternatives, the use of historical data to estimate political costs is highly suspect.

History serves as an incomplete and ambiguous basis for political calculations, and *only* on tried alternatives. Constituents can hardly predict the patterns of change in their own unexpressed preferences and potential strategies and skills under different institutions and policies, let alone these factors for others throughout society. They lack data on both experience with alternatives and the particular adjustments needed to relate past experience to their own futures. One could claim that constituents can still manage to discern the overall costs of political choice. If we assume this extreme position to be correct, we must also ask if this data allows constituents to calculate the *personal costs* of political choice.

General versus Personal Implications

²⁹ In other words, if we assume that the Chicago ‘contextual independence’ assumption might hold sometimes, we need to know when it does, but cannot because this data itself depends upon contexts that cannot coexist.

One could argue that experts in academia can inform constituents about political alternatives. Yet, experts have sometimes ignored sound evidence³⁰. Such false impressions do not last indefinitely, yet disagreement among academics concerning institutions persists³¹.

Even if experts agree, the data that we have is highly aggregated. History informs constituents of *general results* as they apply to members of a community as a whole rather than the *specific outcomes* that constituents require. Rational choice requires data on *private* returns. Claims that aggregate data deliver this result fail due to the fallacy of division.

For each potential institutional order that constituents can vote or lobby for there exists; a set of political strategies they can use, probabilities for success for each of these strategies, a range of possible outcomes for overall economic performance for each set of institutions, a probability for each of these outcomes, a range of possible distributions of individual payoffs within each overall outcome, and a probability distribution for the likelihood of getting particular payoffs within each distribution³². This all depends upon data that resides within the minds of others and has not even been fully developed or created yet. Strategies, innovations, and preferences emerge according to constituent's initial decision. Constituents must access this data *ex ante* to recognize profitable political strategies, but how can they?

Given complete knowledge of each constituent's possible patterns of change in preferences and abilities, agents with unlimited cognitive abilities could calculate political opportunity costs precisely. Given cognitive limitations and stable, and imperfect but contextually independent information, we might take seriously the claim that agents iteratively delete inferior political strategies, given transition costs. However, contextual

³⁰ See Hollander (1998) and Klein (1999)

³¹ See (Pitlik 2002). Knack (1996) Knack and Keefer (1995) versus Sen (2000) or Stiglitz (2002).

³² Fernandez and Rodrik (1991) argue that risk concerning gains and losses from reform impede it. They distinguish between actual and expected *uniform* payoffs based on the risk of getting known payoffs *within distinct aggregate classes*. The actual problem that agents face is uncertainty concerning ranges of varied individual payoffs and related unique, but unclear, probabilities.

dependence and immense complexity combine to render the formation of informed political expectations *concerning individual returns* implausible. The structure of ranges of possible personal and overall outcomes and their respective probability distributions depend upon data that emerge from other minds, that has yet to develop even within our own minds. Since social processes themselves uniquely shape each constituents experiential learning, they each lack vital data on the implications social or political choice on their own interests.

Their lack of data on the state and possible trajectories of change in preferences, strategies, abilities, and technologies under alternative political strategies leaves constituents ignorant not only in terms of how they will fit into resulting states of affairs, but also in terms of what positions and payoffs will exist therein. Constituents are therefore ignorant of both their position under alternative institutions and of the specifics of what positions there will be. Thus, it is more than possible to have knowledge of and agreement upon the efficacy of institutional change overall, with neither agreement to nor knowledge of the specific nature and distribution of its benefits. Constituents will probably never attain even this level of understanding, as historical data ignore untried options and lacks clarity.

This lack of data on how patterns of social interaction would evolve under alternative political strategies prevents constituents from knowing if it is worth voting or lobbying for alternatives to the status quo. Each must each choose among a wide range of possible *initial* strategies given their *initial* preferences that account for unique conditions that will unfold only with experience- as they interact among others who face the same problem³³. How can they do this without something equivalent to prices to inform them of *their* costs?

The general results of different institutions and policies concern data that are widely dispersed among many minds and depend upon a multitude of emerging patterns in personal

³³ That is, agents must anticipate how others will react to political ignorance if they are to deal with it.

reactions, interactions, innovations, and errors. Even if constituents roughly estimate overall political opportunity costs from history, and establish some of the personal payoffs within past institutional regimes, this information describes neither the individual payoffs that will exist nor the probabilities as to which ones each might realize. They need data on how their *own* circumstances will unfold in different institutional contexts to discern these costs.

Relative prices of goods inform each about the costs of economic choice in markets.

Political competition does not establish relative prices between institutional alternatives for individual constituents to use in calculating their personal opportunity costs.

Conscious political reform delivers efficient institutions and policies only if constituents perceive the relevant personal implications of their decisions. They can appeal to experts on general results about which they agree, but not on the personal implications of political reform. Consequently, each discovers their place in any new order *only* after committing to and experiencing its results. Constituents will then each learn if it meets their expectations, if any, but will also lack similar knowledge regarding alternatives forgone³⁴. Since constituents lack full knowledge of even their own preferences and strategies *ex ante*, politics will deliver optimal institutions only through accidents in their political designs.

³⁴ Hayek (1960 p27) briefly notes that, “once a more efficient tool (in the widest sense of the word) is available, it will be used without our knowing why it is better, *or even what the alternatives are* (emphasis added).

II The Myth of Efficient Politics

There is a certain consistency to early Keynesian thought. With static expectations, our actions are so predictable that sound accounting for political costs would not be entirely absurd. This would simplify the conscious design of institutions and policies immensely. Rational Expectations lessens the need for political control of society because it indicates market efficiency. But the grafting of this principle onto Public Choice theory by Chicago theorists makes political control itself only *appear* more efficient. The extension of this principle to politics entails an internal inconsistency. Rational strategic interaction makes social outcomes far more difficult to comprehend, compared to a world of static expectations. Attempts to form rational expectations generally make the actual formation of rational expectations in politics vastly more difficult, and in a context that lacks anything like prices to inform personal choice. Consequently, rational constituents act as if they have static expectations, allowing inferior institutions to persist, not because they are irrational, but instead because they lack any practical means of accounting for the costs of forgone political alternatives. Chicago Public Choice carries human reason beyond reasonable limits.

The Chicago Public Choice literature does contain legitimate insights into the ability constituents to compile data on existing political options, but it ignores true cost estimation. Peltzman (1990) finds that voting aggregates information efficiently because voters correctly use relevant data on economic performance during an incumbents' term³⁵. Wittman stresses that political advertising and lobbying transmit data on *actual performance* of politicians (1995 pp 77-81)³⁶. This all concerns actual experience, not unique forgone alternatives. The

³⁵ Peltzman focuses on disproving the Political Business Cycle hypothesis that politicians fool voters about their records. This concerns the collection of data on actual experience under existing institutions, and therefore fails to address the opportunity cost issue.

³⁶ He argues that political competition leads to the dissemination of data, and there are penalties for disseminating false data, if caught. Politicians will also reduce information costs by providing data on their own and their opponents history and future plans.

efficiency of those outcomes depends upon the ability of the voters to perceive the value of rejected alternatives. Actual competition does inform voters on a data set, but since actual processes under forgone alternatives never happen, alternative data sets remain unobserved. It is important to realize that competition within any institutional order generates a vast and *unique* body of data³⁷. The indispensability of observing actual competition in revealing data makes the problems of discerning data on forgone alternatives more apparent. By arguing for the informational efficiency of *chosen* political processes Peltzman and Wittman unwittingly support the case for Political Ignorance. By showing the importance of actual experience they indicate that constituents know little about forgone options³⁸.

Wittman claims that reputation and advertising informs voters. Voters do not need to observe politicians personally because each can find a person or organization with a *similar mindset* to inform them (1989 p1400). They can find information on the opinions and records of politicians, just as politicians can find data on the opinions and voting records of the electorate through polling and research. The problem of estimating costs is not one of amassing opinions concerning the alternatives. It is one of acquiring *changing* data on the objective facts that inform such opinions. **Evolving opinions also make *differing mindsets* relevant. This all escalates the computational difficulties of politics relative to markets.**

Wittman claims that efficient policies will dominate inefficient median voter results (1989 p 1413). He contends that “a candidate might come on (efficient policies) by trial and error, or perhaps there might exist a demand revelation mechanism that yields the efficient outcome”. This first possibility fails because actual trials and errors yield incomplete

³⁷ Lavoie (1985) discusses how ‘social intelligence’ emerges from competition. Since people cannot fathom the sum of human knowledge in practice, it follows that they cannot do this outside of experience either. They therefore lack even the most fundamental basis for collecting data on forgone institutions.

³⁸ Breton (1989) also ignores problems with acquiring data on political alternatives. He does not explain how agents acquire data on political opportunity costs. He lists three building blocks for understanding government-theory built upon prices, income and preferences; indifference between identical goods from different sources (public and private); and the notion that there are many sources of goods for agents to choose from.

ambiguous *aggregate* results only. The second amounts to a mere expression of faith on his part. Such speculation concerning a hypothetical and completely undescribed demand revelation mechanism does nothing to show how constituents become informed of actual costs. Stigler (1992, p459) expresses a similar conviction when he writes that “New and experimental institutions will rise to challenge the existing systems ... Tested institutions found wanting will not survive a world of rational people”. Where, exactly, do agents get information regarding the likely personal outcomes of challenging tested institutions? One finds an institution wanting by comparing their projected payoffs under the current system to the likely payoffs from reform. The arguments of this paper indicate that we cannot merely assume (as do Wittman and Stigler) that agents can acquire this data.

Wittman also commits the fallacy of division in claiming that the ability of constituents to observe principals whenever researchers can negates arguments for inefficient informational asymmetries (1995, p108). Constituents must not only observe public officials, they must discern private benefits to disciplining these agents while considering how they would behave under alternative rules.

Becker and Wittman avoid having to explain 20th century totalitarianism by arguing that only democracy is efficient. However, they still must explain the wide discrepancy between the results of democracy in places like India as compared to the US or UK. They also face a problem in explaining the rarity of democracies historically as well as the existence of a number of highly successful non-democratic nations³⁹. They must address the issues raised in Stigler’s more general point about efficient institutional reform.

³⁹ Tullock (2002) argues that non-democratic governments are the norm throughout history. Also, Lott (1997b) argues that competition does occur outside of democracies. These arguments and experiences do inform us on the performance of different institutions within particular contexts. However, this data is highly aggregated and contextually dependent. Academics can learn something from it, but it is not clear that agents can put it to use in forming political plans.

Stigler's insistence that constituents use the state only when it is the most efficient means to given ends assumes contextual independence of data⁴⁰. Since constituents learn data through complex social interactions within institutions, whose incentives shape outcomes as well as related data, contextual dependence of data is inescapable. We cannot merely assume that persistence implies efficiency. With the passage of time constituents might be *less* able to estimate political opportunity costs because data on examples of institutional alternatives will be less suited to the present context. Persistence can indicate ignorance and entrenchment, rather than efficiency, in the process of conscious reform. As Stigler put it earlier "we can get on a bus called reform, but we do not know where it will take us" (Stigler 1975).

The parallels that Chicago theorists draw between economic and political competition are partially true, but they ignore the implications of their own reasoning concerning cost estimation in politics. Their implicit assumption of contextual independence places the burden of explaining political error on search and transition costs. The arguments of this paper indicate that constituent choice in politics does not compare to private choice in markets. Yet, in order for these arguments to be more than academic we must ask if there exists an alternative to conscious political control over social institutions and policies. Can vital social institutions function in the absence of politics?

III Politics versus Markets

History is replete with examples of faulty institutions that persist, despite our ability to imagine and even observe superior alternatives. Empirical studies indicate that markets are ubiquitous, but seldom as efficient as in the West, where property rights are most secure and special interests least troublesome (Olson 2000). De Soto (2003) estimates that the poor of the third world hold 9.3 trillion dollars of assets outside of the official legal system- a

⁴⁰ See Stigler (1986) page 3-4

condition that prevents these people from applying these assets to their most productive uses. Proposals to restrain special interests and expand the impartial rule of law are hardly new. Yet, reforms that deal with these problems remain a historical rarity. Collective action and principal-agent problems in Public Choice can surely inhibit productive reforms.

The proposition of a more fundamental informational problem in politics adds much force to arguments for political failure. Egyptians alone hold 240 billion dollars of extra-legal assets. Early Americans faced a similar situation and enacted effective reforms solved it in a matter of decades. Yet, Egyptians have failed to develop efficient legal/political institutions after thousands of years. Chicago Public Choice suggests an invisible hand of politics. This proposition fails in theory and practice, but does political failure outweigh market failure?

Virginia Public Choice recognizes political failure in theory and practice. Olson (2000) even suggests that democratic governance is more efficient than dictatorship, *but it arises only by accident*. This paper suggests an additional reason for such failure. In addition to individuals facing high transactions costs when organizing to promote the common good, these general benefits are unclear, and specific personal payoffs are unknowable. As Fremling and Lott argue, such a lack of data causes constituents to underestimate relations between reform and their own welfare. **Thus**, politics systematically under produces reform due to ignorance.

Social security reforms are rare. Reform succeeded in Chile, but only after that program had deteriorated to a point where constituents had little to lose by abandoning the old system⁴¹. Evidence exists indicating that public policy drove the decline of Ancient Rome⁴².

Were reforms to arrest or reverse such decline prevented by political transaction costs? The

⁴¹ Advocates of reform promise higher rates growth and better investment returns overall, but the personal benefits of such large-scale reforms are much less clear. The national scale of the politics of these reforms also makes personal transition costs in the political process unclear. But, even now some doubt the success of this Chilean reform. See (Agosin 2001).

⁴² Schuettinger and Butler (1979) discuss the deleterious policies of Emperor Diocletian. Bartlett (1994) argues that excessive taxation, inflation, and over-regulation caused the fall of Rome. Increasingly burdensome transfers to special interests reduced growth and left Rome unable to defend itself from barbarian invasion.

idea that transaction costs made Rome's decline unavoidable, suggests that the dark ages that followed were optimal. Public education in the US serves as another example. The persistent failure many inner city and rural schools calls the efficiency of local politics into question. Since the politics of education are largely local and constituents understand much of the overall benefits to improved education, the standard rational voter abstention and ignorance explanations for failure are less likely. The varied results of public and private education make the general results of reform less clear. What is clear is that per student spending has tripled in real terms, while overall results have declined (Hanushek 1996). However, this does not inform constituents of net personal benefits of investing their resources in reform. To estimate their returns to reforming education they must anticipate, among other things, the future development of particular children in significantly different contexts. Estimates of these net benefits are highly speculative⁴³.

If political rivalry fails to inform constituents of even personal costs we should consider alternatives to political control over resources. The main point of this paper is that constituents lack data they need to perform utilitarian cost benefit calculations comparable to those they make as in private markets. Political action instead relies heavily on unformed conjecture or ideology. Values and ideology do appear to affect economic development through politics (Weber 1904, Sen 2000, De Soto 2003). Regrettably, these influences rarely serve as a good substitute for self interested action based on the sound utilitarian calculations that politics lacks. While market prices extend our private interests beyond the limits of our

⁴³ Lieberman (1993 p 139) claims that none of us knows the current monetary costs of public education because "they are diffuse and intermingled with others beyond recognition". He also writes that "At the present time, private schools do not constitute a market system. Even if we knew the full costs and outcomes of private schools, *and we do not*, the information would not enable us to compare the efficiency of public education with a market system of education" (p114 emphasis added). The observed efficiency level in private schools does not represent the outcomes that would result in a market system because this does not reflect potential improvements in service quality and/or service cost (p142). He admits (p 316) that given scores of factors in assessing education little is known about the relative importance of these factors. The benefits to reform are thus unclear, especially in the long run. This indicates political ignorance regarding public education.

comprehension, politics expands conscious control of resources beyond what any mind can comprehend. The question then is can society function without activist politics?

Vital institutions (i.e. money, common law) emerge and evolve as unintended consequences of the pursuit of self interest (Radford 1945, Hayek 1967b). Plausible arguments and some evidence exist to indicate that society can operate within this kind of anarchistic order⁴⁴. Such institutions eliminate conscious deliberation over the costs of social choice. These institutions are imperfect, but the lack of any basis for informed social choice makes the prospects for improving them through politics most unlikely. Alternatively, Nozick (1974), Hayek (1944), and Mises (1927) argue for a minimal state that mainly enforces property rights. The costs of Political Ignorance might not be serious under such a state, particularly if it emerged spontaneously, as envisaged by Nozick.

Further analysis of the viability such orders is beyond the scope of this paper, but Political Ignorance does make virtual or total abolition of the state more attractive. Of course, carrying out such changes would require constituents to calculate the private benefits of a type of political action- radical privatization. The difference here is that constituents are not judging the merits of different political orders, but are instead deciding between political and market orders in general, and in light of the fact that they will never know which political order is best. It may therefore be the case that the only proper role for conscious deliberation over **political** reform and public policy is a simple recognition that we should not deliberate over these matters at all.

⁴⁴ Iceland functioned without *any* government for 300 years (Friedman 1989). Hong Kong developed rapidly with a minimal state (Rabushka 1979). Lavoie (1985) rejects both comprehensive and partial state planning in favor of comprehensive market order- anarchy. In his *Law, Legislation, and Liberty* Hayek asserts that society would continue without the state. Anarchy eliminates political ignorance by eliminating social choice.

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