

The Use of Knowledge about Society

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Revision requested by *The Journal of Economic Behavior and Organization*

Last revised on September 10th, 2005

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.

JEL Classification: D71, D83, O17, H11, P11, P21

Key Words: Institutions, Political Reform, Economic Performance

I thank Tyler Cowen, Randal Holcombe, James Buchanan, Gordon Tullock, Mario Rizzo, Charles Rowley, Don Lavoie, Richard Wagner, Tom Rustici, Rebecca Menes, and Erik Tallroth and two anonymous referees for commenting on drafts of this paper. The comments from Professors Cowen, Holcombe, and Buchanan were particularly helpful. The usual disclaimer applies.

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 some fail to learn from centuries of success in the West indicates serious problems with deliberate planning of political reform.

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 low cost methods of wealth transference garner stronger political support, so policies that persist are efficient. 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.

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.

This paper argues that political competition delivers widely varying and frequently poor results because constituents lack data on the opportunity costs of political reform. *Political opportunity costs* are the net present value of the next best alternative political strategy to a constituent. Whenever constituents select a political strategy (voting or lobbying to establish or alter public institutions and policies) they forgo others strategies and their results⁵. They must acquire data on the net present values (including transition costs) of these alternatives to form rational 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 constituents can acquire data needed to attain *practical goals* via politics. They cannot acquire data for cost minimizing political calculations pertaining to institutional choice and public policy.

The first part of this paper argues that the immense complexity of political choice and the lack of an effective means reckoning political alternatives (i.e. a price system) lead to radical uncertainty regarding political reform⁷. A-priori theorizing fails to inform constituents of political opportunity costs. Deficiencies in empirical data prevent the “a-posteriori” calculation of these costs. The second part critiques Chicago Public Choice.

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.

⁷ See Knight (1921) Keynes (1937) and Shackle (1938, 1958) on radical uncertainty.

The final part considers the merits of private and public institutions given the arguments of this paper.

Informed Expectations

Rational Expectations theory examines misestimation of known relationships that may cancel out, but problems in identifying correct *linear* relations between variables causes underestimation of true relationships. These errors do not cancel (Fremling and Lott 1996)⁸. Constituents must also account for non-linear relations and changes in these relations through time. This paper examines problems in accounting for 2nd or 3rd order and temporal changes in the identification phase of expectations formation.

Consumers introspect for data on their preferences and use market prices and experience to estimate costs. Preferences may change in unexpected ways⁹. Consumers face initial uncertainty as such changes occur, but each has the best insights on relevant patterns of change, and experience and dispels this uncertainty. Prices convey data regarding the relative rates of exchange that others will accept, given their preferences and incomes (Hayek 1948b). Given an efficient price system, consumers use available data to move towards preferred alternatives. Entrepreneurial choice is complex, but the profit motive prompts entrepreneurs to delete inferior strategies and move towards efficiency (Alchian 1950, 1963). Market prices serve as a basis for accessing data from other minds on costs. Does political competition provide a comparable means for cost accounting?

Data on the results of reform emerges from different social contexts. The Chicago-Virginia debate focuses on how politicians learn the preferences of constituents, and how constituents learn of political platforms, regardless of institutional context. Both sides

⁸ With six variables there are over one billion sets of linear causal connections. The possibility of non-linear relations and accounting for how opposing constituents choose strategies complicates matters further.

⁹ See Hayek 1961 and Stigler and Becker 1977 on how preferences develop.

assume that data on different institutional contexts derive from data available in any such context. This proposition should be demonstrated or rejected, but not merely assumed.

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 relevant to each decision. The emergent nature of political preferences makes a-priori understanding of these preferences impossible. Political preferences derive from ideological beliefs concerning collective goals and individual rights, and exist in many forms¹⁰. Upon entering politics, constituents perceive existing political states, imagine better states, and consider alternative means of improving their condition¹¹. Each begins with a distinct ideological or philosophic conception of what rights should be, and even of what policies and rights currently exist.

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 rationale behind them.

¹⁰ As Stigler (1992 p 459) notes, "Maximum national income, however, is not the only goal of our nation".

¹¹ 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. See also 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.

Nearly all constituents acquire preferences for particular policies by adopting systems of belief that emerged out of debate¹². Constituents therefore initially lack data on their own fundamental preferences, and will never know if this data is complete¹³.

Since each political decision is for many, iteration concerning preferences will take place between many minds, rather than within individual minds. Constituents are less able to predict patterns of change for minds other than their own, so they predicting changes in preferences is more difficult for politics than in markets. 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 of those who want something else. This induces far more intense and complex reactions because it forces some to endure undesirable results¹⁴. 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 estimates of true preferences and related strategies.

Prior to entering politics, constituents are ignorant of the strategies and goals, 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 know how their own skills and strategies will change, they cannot anticipate changes in other minds¹⁵. They therefore lack a-priori data of the outcomes of strategic interaction in politics even if with full

¹² Only a few (i.e. Marx or Locke) played a significant role in developing their own political preferences.

¹³ As Hayek (1960) notes, the mind cannot predict its own advance.

¹⁴ There is a serious difference between failure to secure one good, and being forced to consume another good.

¹⁵ That is, it is completely absurd to say that the mind can predict how other minds will advance.

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 creates this data¹⁶.

Constituents must also discount returns from political action according to expected lags in realizing results. The reactions of opponents and allies will hinder or propel reform. 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 the intentions of associates, and switching costs between constituencies often make self-selection by constituents less viable.

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. Theory can at best deliver *ordinal* rankings of political alternatives. Varying underlying conditions make even ordinal rankings imprecise, and constituents

¹⁶ Schumpeter (1950 p 286) argues that the 'tremendous loss of energy' from incessant legislative battles impairs democracy. This overlooks how these 'incessant battles' reveal data on real political conditions.

need *cardinal* measurements to account for 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 data on institutional performance¹⁷. Does this give constituents enough of the right quality and type of data to estimate political costs? 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 estimate political costs?

In markets prices serve to inform individuals of costs. Political choice lacks this mechanism. Statistical data is highly aggregated and largely in pecuniary form, so there are often several interpretations specific underlying conditions for any specific prices. The use of historical data to make political decisions about the future requires constituents to adjust data on causal connections between specific institutions and policies and changes in welfare for differences in underlying conditions between the past and the future.

Vihanto (1992) argues that competition between local governments leads to surprising discoveries of preferences for local public goods, and 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 jurisdiction and the outcome that would have obtained with alternative institutions. Constituents can use the experiences of others if these experiences approximate the outcomes that would result from their own political actions, and to the extent that they can perceive such approximations. They need to adjust for differences between historical and potential circumstances.

¹⁷ For example, see Pitlick (2002), Gwartney, Lawson, and Holcombe (1999) or Haan and Siermann (1998)

Results between constituencies may vary because of differences in the political skills and goals of politicians and the political skills, time preferences, and philosophic or religious beliefs of different constituencies. This introduces ambiguity in to the historical record. Failures in East European reforms might derive from ideological differences between East and West, weak but essential political skills, or varying discount rates.

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 that each faces in politics makes this problem worse than in markets. Constituents must disaggregate data correctly to see links between individual institutions and overall economic results. Since different polities have differences and similarities in institutions and other factors, ambiguity in these causal connections misleads constituents in their political calculations¹⁸. We also lack sound data for most of history, particularly with underground elements of the economy¹⁹.

Factor migration between polities provides unclear evidence that one has inferior institutions (Olson 1996). Bolshevism drove high productivity workers out of East Germany. This inflated the performance of West German institutions, but by how much? Also, trade barriers affect productivity by limiting innovation in labor skills deriving from division of labor. Strategic maneuvering introduces more ambiguity into these comparisons, as constituents must predict alternate trajectories for individual strategies

¹⁸ Chang (1998) argues that failure to satisfy local demands for redistribution may lead to political unrest that deters investment and slows development. Such pacification may also lead investors to anticipate more takings. Chang emphasizes that Westerners ignore local political conditions in Asian nations. Local differences call for unique institutions, but how do constituents know when foreign examples apply to their own situation?

¹⁹ 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. Also For example, Fogel and Engerman (1995) use scant available data to estimate the 'wages' of slaves.

under different institutions. Interregional comparisons inform constituents about the merits of reform only if they can adjust for how innovation would evolve alternatively.

Even if constituents adjust all of these factors, local competition between alternative institutions conceals potential benefits of greater institutional uniformity. Reliance on national programs, such as in Europe, may limit free riding on public goods or increase public choice problems in policy and the bureaucracy. Experience may reveal ways of minimizing the administrative costs of such arrangements. Or uniformity may cause more rent seeking. Competition between state and local government in the US may limit rent seeking. Since constituents never experience specific institutions at local and national levels concurrently each set of institutions generates unique results through experience.

Secession and expulsion 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 form new institutions, these two approaches to political exit each generate unique results.

Constituents must also adjust for how the duration of institutions affects 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, but informs constituents of transition costs.

Institutional longevity hides data on transition costs and limits the number of institutional orders of which we can learn. Yet constituents need stable and lasting institutions to gauge their performance. The Soviet experience taught us much about how state socialism functions- in Eastern and Central Europe for twentieth century Europeans.

How else could things have turned out for these people? How can others relate the unclear costs of Bolshevism to their own options?

Small differences in growth cause large differences in living standards over time. These rates depend upon innovations and time preferences from others, so small errors in ex ante estimates of the affects of reform will lead to large errors in estimates of long term welfare²⁰. By comparing institutions in the same place but at different times we eliminate the need to adjust for trade and migration. But, differences in underlying conditions will likely multiply. A comparison of liberal reforms in mid 19th century Sweden to the rise of the Swedish welfare state a century later serves to inform. Yet, we must adjust for Sweden's unique role as a non-combatant in the Second World War, as well as a multitude of differences in the Sweden of that time, and in its trading partners. 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 change in a single area- even if there is little migration²¹. Each possible order delivers unique results, so comparisons between political alternatives require adjustments for differences in skills, scale, duration, strategic interaction, migration, ideological beliefs, and resource constraints of the past and present.

Observed disparities in economic performance exist due to variations in past political conditions and errors. Constituents 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

²⁰ Constituents face particularly difficult problems if agents account for the welfare of future generations. To account for intergenerational welfare, they must form expectations the actions and welfare for those who *would be born* under alternative paths of institutional evolution (Parfit 1986).

²¹ As already noted, migration between time periods is impossible, but migration through time can alter underlying conditions and render comparisons across time invalid.

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 believed²². 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.

Patterns of mutual plan adjustment evolve differently under different institutions. If these patterns were identical, the use of historical data to estimate political opportunity costs would require no adjustments. In some instances, patterns may evolve in a similar fashion thus negating the need for these costly adjustments. But, constituents only know *if* these patterns do or do not change through experience, or by 'introspecting' into minds other than their own²³. Market prices substitute for direct insight into other minds concerning marginal costs. Politics lacks a comparable means of conveying such data.

Constituents make political choices within existing institutions, using data compiled within that context, and concerning interaction within that context. Each historical period produces results from specific preferences, strategies, abilities, technologies, and errors- all within the institutions of that time. Constituents can barely predict changes in their own preferences, strategies, and skills under different institutions and policies, let alone these factors for others. Since each historical period is unique, and constituents know little of

²² Hayek (1967a p39) uses argument from Karl Popper's *On the Sources of Knowledge and Ignorance* (1960)

²³ 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.

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. One could claim that they can discern the overall costs of political choice. If we assume this extreme position, we must also ask if it allows constituents to estimate the *personal costs* of political choice.

General versus Personal Implications

One could argue that experts in academia can inform constituents of political costs. Yet, experts have often ignored evidence. Nutter (1958) provided evidence to show that the Soviet Union made little progress in producing consumer goods, and instead focused more on capital and military goods. Official statistics from the USSR were 'mythical' and grossly exaggerated. Yet, some economists persisted in praising soviet system until shortly before its demise²⁴. Even if experts agree, the data that we provide is 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 informs personal choice entail the fallacy of division.

²⁴ To Samuelson (1985) "there can be no doubt that the Soviet planning system has been a powerful engine for economic growth...The Soviet model has surely demonstrated that a command economy is capable of mobilizing resources for rapid growth." Also "The Soviet Union is proof that a command economy can function and even thrive" (Samuelson 1989). Galbraith (1984) claimed "that the Soviet system has made great material progress in recent years is evident both from the statistics and from the general urban scene...One sees it in the appearance of well-being of the people on the streets...and the general aspect of restaurants, theaters, and shops... Partly, the Russian system succeeds because, in contrast with the Western industrial economies, it makes full use of its manpower". He also asserted that "On the economic front, for the first time in its history the Soviet leadership was able to pursue successfully a policy of guns and butter as well as growth ... The Soviet citizen-worker, peasant, and professional – has become accustomed in the Brezhnev period to an uninterrupted upward trend in his well-being". Thurow (1989) claimed that the remarkable performance of the Soviet Union suggests that economic command can significantly compress and accelerate the growth process, and "today (Russia) is a country whose economic achievements bear comparison with those of the United States".

For each possible institutional order there exists; a set of political strategies, probabilities for success for each of these strategies, a range of possible outcomes for overall economic performance, a probability for each of these outcomes, a range of possible distributions of individual payoffs within each overall outcome, and a probability of getting each payoff within each distribution²⁵. Constituents must access this *undeveloped* 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 constituents iteratively delete inferior political strategies, given transition costs. However, contextual 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. The resulting lack of data political alternatives 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

²⁵ 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.

even this level of understanding, as historical data ignore untried options and lacks clarity.

Ignorance of how social interaction would evolve under alternative institutions means that constituents must each choose among many *initial* strategies given *initial* preferences and unique conditions that unfold only with experience- as they interact among others who face the same problem²⁶. How can they do this without something like prices to inform them of *their* costs? Even if they can estimate overall political costs from history, and establish past personal costs, this does not reveal the expected individual payoffs that could exist. They need data on how their *own* circumstances will unfold in different institutional contexts to calculate costs. Political competition does not establish anything like prices between political alternatives as approximate measures of cost.

Constituents can appeal to experts on general results about which they agree, but not on the personal implications of political reform. Each discovers their place in any new order *only* after experiencing its results, but will lack similar data on alternatives forgone²⁷. Since they lack knowledge of even their own preferences and strategies *ex ante*, politics will deliver optimal institutions only through accidents in political designs.

II The Myth of Efficient Politics

There is a certain consistency to early Keynesian thought. With static expectations, our actions are so predictable that accounting for the costs of political action might not be absurd. Rational expectations indicate market efficiency, and thus less the need for political control of society. But the extension of this principle to Public Choice theory entails an internal inconsistency. The idea that individuals interact strategically means that

²⁶ That is, agents must anticipate how others will react to political ignorance if they are to deal with it.

²⁷ 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).

the results of collective or political action are vastly more complex and less predictable than in a world of static expectations. Individual attempts to form rational expectations make expectation formation in politics vastly more difficult, and in a context that lacks anything like prices to inform personal choice. Rational constituents effectively have static expectations, allowing inferior institutions to persist, not because they are irrational, but because they lack any practical means of accounting for forgone political alternatives. Chicago Public Choice carries human reason beyond reasonable limits.

Chicago Public Choice contains legitimate insights into the ability constituents to compile data on chosen political options, but it ignores true cost estimation. Peltzman (1990) claims that use of relevant data on economic performance during an incumbent's term leads to efficient data aggregation²⁸. Wittman stresses that political advertising and lobbying transmit data on *actual performance* of politicians (1995 pp 77-81)²⁹. This concerns actual experience, not forgone alternatives. The 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, the same data on alternatives remain unknown³⁰. By arguing for the indispensability of actual competition in revealing data 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 options³¹.

²⁸ Peltzman argues against Political Business Cycles and the idea that politicians fool voters about their records. This concerns data on actual experience, and therefore fails to address the opportunity cost issue.

²⁹ He argues that political competition disseminates data and penalizes dissemination of false data. Politicians also reduce information costs by providing data on their own and their opponents history and future plans.

³⁰ Lavoie (1985) argues that since people cannot fathom the sum of human knowledge in practice, they cannot do this outside of experience. This also implies the lack any basis for calculation costs of forgone institutions.

³¹ Breton (1989) also ignores problems with acquiring data on political alternatives. He lists three building blocks for understanding government- theory built upon prices, income and preferences; indifference

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 claims 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 ambiguous *aggregate* results only. The second amounts to a mere expression of faith on his part. Speculation about a hypothetical and completely undescribed demand revelation mechanism does nothing to show how constituents become informed of real 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”³². Where do agents get data on likely personal outcomes of challenging tested institutions? One finds an institution wanting by comparing their projected payoffs under the current system to the likely

between identical goods from different sources (public and private); and the notion that there are many sources of goods for agents to choose from. None of this explains political cost calculation.

³² Hayek (1973 p60) comes very close to this issue. He describes hope in such experiments as an illusion.

payoffs from reform. We cannot merely assume (as do Wittman and Stigler) that constituents 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 (1976 p246) *assumes* that voters have unbiased expectations. "They may overestimate the dead weight loss from some policies, and underestimate it from others, but on the average they have a correct perception." The proposition that "they" perceive overall dead weight losses for actual policies accurately does not address the private cost issue. Efficiency in this context requires individual constituents to arrive at accurate perceptions of the personal costs of the dead weight loss from forgone alternative policies, so they can form rational expectations concerning political reform. The difficulty in doing this is not due to any particular known biases in actual perceptions, but rather to the absence of a process that reveals *individual* political costs.

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 nations³³. They must address the issues raised in Stigler's more general point about efficient institutional reform.

³³ Tullock (2002) notes that non-democratic governments are the norm in history. Lott (1997b) argues that competition occurs outside of democracy. This informs us on institutional performance in different

Stigler's insistence that constituents use the state only when it is the most efficient means to their ends assumes contextual independence of data³⁴. Since constituents learn data through complex social interaction within specific institutional contexts 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 indicates ignorance and entrenchment, rather than efficiency, in the process of conscious reform. As Stigler put it in 1975 "we can get on a bus called reform, but we do not know where it will take us".

Chicago Public Choice suggests an invisible hand of politics. The parallels that Chicago theorists draw between economic and political competition are true, but they ignore the implications of their own reasoning for political cost estimation. Their implicit assumption of contextual independence places the burden of explaining political error on search and transition costs. 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 underestimation of relations between reform and their own welfare. **Thus**, politics systematically under produces reform due to ignorance. Yet, in order for this to be more than academic we must ask if there exists an alternative to conscious political control over

contexts, but this is aggregate and contextually dependent data. How can constituents use it to estimate costs?

³⁴ See Stigler (1986) page 3-4

social institutions and policies. Can vital social institutions function in the absence of conscious political control?

III History and Progress

If the arguments of this paper are true utilitarian calculations play virtually no part in reform, and reform comes instead from ideological change and historical accidents. A few broad facts support these propositions. Civilization and government have existed for thousands of years, yet sustained economic development in the West began only a couple of centuries ago. This development coincided with reforms for less intrusive and more democratic government. These reforms resulted from the spread of the liberal individualism of the enlightenment. Yet, as people began to expect sustained progress the institutions of the enlightenment were seen as impediments to further progress (Hayek 1944 p21). This impression derived from a change in the trend of ideas towards collectivists like Hegel, Marx and List (ibid p25). De Soto (2003) and Olson (2000) observe that Western prosperity depends heavily upon secure property rights and relatively docile special interests. People outside of the industrialized world have the physical means of developing. Yet they fail to overcome apparent institutional obstacles to emulating Western development. Nations like India and Russia have failed in both pioneering and emulating productive reform. One could blame the problems of these nations on the lack of democracy and effective political competition. Yet, Western nations also lacked democracy, and became democratic only very gradually. De Soto describes the emergence of an efficient property rights system in the US during the *least* democratic period of US history. The USSR had its greatest industrial success during under the tyranny of Stalin (Olson 2000). Decentralization and competition in the post-Stalin era resulted in decline (ibid). Post Soviet democratic reforms have also failed to deliver improved economic

conditions. India has also had democracy for decades, yet dire economic conditions persist for millions of Indians.

While the simultaneous rise of Western industry and Western democracy support the idea of democratic efficiency somewhat, other examples cast doubt on this contention. There is more consistent support for a connection between less intrusive minimalist states and sustained economic development. This fits with the arguments of this paper. Nozick (1974), Hayek (1944), and Mises (1927) argue for a minimal protective state. Most would agree that the alternative to having a state is chaos³⁵. Both the overall and personal costs of civil disorder are obvious to the point where there is no difficulty in making accurate political calculations. The decision between a minimal and interventionist state is less obvious.

The key distinction we must make at this point is between interaction within rules and action concerning the rules themselves. An activist state aims at regulating the outcomes of social interaction. Yet we do not know how spontaneous social interaction will work to solve problems beforehand (Hayek 1973 p63). A minimalist state avoids some parts of the problem of political ignorance. It enforces laws that are independent of any end purpose by restricting uncivil conduct and protecting the right of each to form and execute their own personal plans. There are certain 'no-brainer' political calculations. Laws against murder are an obvious part of any civilized society. Protection of property rights and the enforcement of private contracts enable the realization of intended gains from

³⁵ Some think otherwise. Iceland functioned without *any* government for 300 years (Friedman 1989). 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.

trade and discovery of new opportunities³⁶. This raises special problems. None can know the private benefits of spontaneous exchange will in advance. The maintenance or establishment of the general rules of conduct of a minimal state (i.e. property rights) entails direct resource costs. Problems might arise in determining the level and form of taxation necessary to fund law enforcement. But the taxes for maintaining a minimal state could be small enough not to matter (Mises 1949 p733-4). It is more important to note that the worst problems of political ignorance arise with attempts by officials of an interventionist state to regulate the outcomes of social interaction. The informational problems of deciding over a few simple rules and public means of enforcing them matter, but are small compared to the problem of determining the extent and form of an activist state through time. The rules of a minimal state derive from unchanging principles, while the activist state must account for continually changing world conditions. Status quo bias in politics is far less problematic for enforcement of simple rules based on unchanging principles than for specific policies and programs that must adapt to changing circumstances in a complex world. Political ignorance is more of a problem for transitioning to a minimal state than for the operation of such a state.

There are many examples of status quo bias in activist government programs. 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 system³⁷. **Demographic changes in the US have lowered rates of return on Social Security and raise questions regarding its overall solvency in the next few decades. The overall**

³⁶ Nathan (2001) asserts that government failure to protect property rights in South Africa has led to significant social losses through inefficient transfer mechanisms, like squatting. The size of these losses are speculative.

³⁷ 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 these reforms also makes personal costs unclear. Also, some doubt the success of this Chilean reform. See (Agosin 2001).

demographic problem with American Social Security has been known for decades, yet Washington politicians refused to even discuss reform until very recently. Evidence indicates that public policies drove the decline of Ancient Rome³⁸. Were reforms to arrest or reverse such decline prevented by political transaction costs? The 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 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). Yet 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 speculative³⁹.

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

³⁸ 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.

³⁹ 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.

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 uniformed conjecture or ideology⁴⁰. 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 comprehension, politics expands conscious control of resources beyond what any of us can comprehend. The question then is can dispense with activist politics.

There is considerable evidence to indicate that the private sector evolves and adapts to solve serious market failures. The research program initiated by Coase (1959, 1974) casts doubt upon the idea that market efficiency absolutely requires an activist state. The profit motive does drive an iterative process that favors efficient private institutions. Externalities introduce an element of social 'choice' into this process, so private competition may involve ignorance of certain serious social consequences. However, private interests innovate to internalize positive externalities, and the internalization of negative externalities *is* a function of property rights enforcement by a minimal state.

Political Ignorance bolsters the case for a minimal state. Transitioning to such a state does require constituents to estimate private benefits of a type of political action- radical privatization. The difference here is that constituents are not judging the merits of different types of activism, but are instead deciding between activism and minarchy- in

⁴⁰ The proposition that ideas matter more than economic or financial interests is not new. As Keynes (1936) noted "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood ... the power of vested interests is vastly exaggerated compared to the gradual encroachment of ideas". Lionel Robins (1934) also noted that ideas can rule the world in the long run.

light of the fact that they will *never* know which activist order is best. It may therefore be the case that the only proper role for conscious deliberation over institutional reform and public policy is a simple recognition that we should not deliberate over these matters at all.

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