

Political Economy

1. How do government decisions actually get made?
 - a. Stiglitz (Four Fallacies) points out that the government has powers that private firms do not have.
 - b. One interpretation is that we collectively give them these powers so that we can achieve collective goals like social insurance.
 - i. This is a *normative* interpretation. It describes how the world should be. Lo, we find that it is that way.
 - c. Another interpretation is that a bunch of people in society gang up on everybody else through the instrument of the state.
 - i. This is a *positive* interpretation. It describes how the world is, without necessarily describing its goodness or badness.
 - d. In public economics, we try to be careful to distinguish descriptions of how the world *should* be (normative statements) from statements of how the world *is* (positive statements).
 - e. The question of how government decisions actually get made is a question of positive economics.
2. Democracy and the Median voter
 - a. The *median* of a distribution is the point in a distribution where half the weight is above the point and half the weight is below.
 - b. For example, the median income level is the level of income such that half the people make more money and half make less money.
 - c. Consider a group voting on a redistribution plan.
 - i. *Progressive redistribution*. The plan is to take everyone in Vancouver, and if they make more than \$25,000 take half their income in excess of this, and then share the total among all the people who make less than \$25,000.
 - (1) we call it *progressive* redistribution because it transfers resources down the distribution, from those who need it less to those who need it more. This is a description of its *goodness*, and therefore a normative description.
 - ii. Assume that nobody changes their behaviour (eg, their work hours) in response to this policy. Thus, is not about efficiency; it is about the distribution of resources. It is about where we are on the frontier, not whether we are on the frontier.
 - iii. In Vancouver, in 2001, the median individual total income was about \$30,000 for persons with positive income aged 25-64.
 - iv. This is not a pareto improvement: it is about switching places on the frontier. Who will like this policy? If people are strictly greedheads, everyone with income over \$25,000 will dislike it, and everyone with income less than \$25,000 will like it.
 - v. In Vancouver, in 2001, 43% of persons with positive income aged 25-64 had income less than \$25,000. 57% had more.
 - vi. Thus, this proposed progressive redistribution policy would be voted

- down.
 - vii. Consider a slightly higher cutoff, eg \$27,000. Then, there would be more voters for the proposal. However, it still would not be enough.
 - viii. Until the cutoff is \$30,000, the proposal will not get the votes. However, for all cutoffs above \$30,000, the proposal will get a majority of votes.
 - ix. This means that the *median voter*, the voter with median income, effectively decides on whether or not the policy goes through.
 - d. Median voter rules apply whenever voters consider a policy that affects a single dimension of their lives (eg, their income), and when their feelings on this single dimension are *single-peaked*, so that you can put voters in order of some observable thing (like their income), and that will put their preferences (like or dislike of the policy) in order, too.
 - e. The definition of democratic decision making—majority rules—puts a heavy emphasis on the preferences of the median voter.
 - f. Median voter rules allow us to *predict* how policies will be supported in the population, and in elections. Median voter rules are thus tools of *positive* economics.
3. Democracy and “the Interests”
- a. Another tool of positive economics used to study the workings of government is the “interest group”.
 - b. An interest group is a group of people with similar needs/preferences/desires who work to get government to do their bidding.
 - c. In the USA, lobby groups, which are licensed well defined interest groups, have an official role in American policy-making.
 - d. In Canada, interest groups exist, though they do not have the same legitimised structure surrounding them.
 - e. Interest groups work directly with government to try to get them to do stuff, and they work to get people to vote for the governments they like.
 - f. To the extent that median voter rules give the same power to each person, the presence of interest groups in society serve to give the same power to each dollar.
 - i. That is, interest groups use money to achieve their goals: lobbying, advertising, doing research, convincing people and politicians of the rightness of their agenda.
 - ii. Interest groups with more money are more effective.