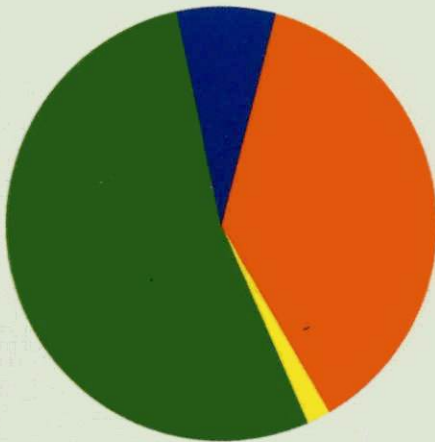
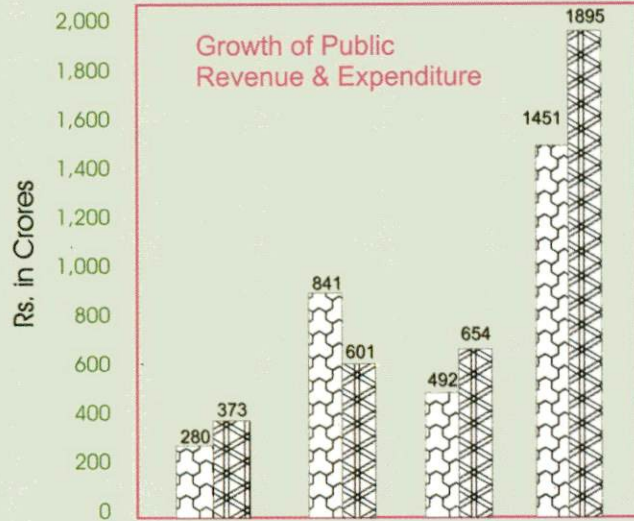




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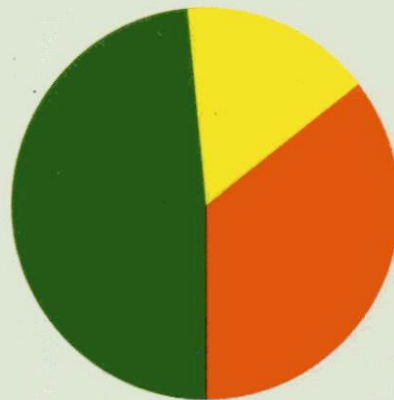
M.A. (PREVIOUS)
PUBLIC ECONOMICS

729



ALLOCATION OF RESOURCES

- Agriculture
- Tertiary Sector
- Industry
- Other Sector



DISTRIBUTION
of
PUBLIC GOODS

- Public Sector Goods
- Private Goods
- Joint Goods

ಉನ್ನತ ಶಿಕ್ಷಣಕ್ಕಾಗಿ ಇರುವ ಅವಕಾಶಗಳನ್ನು ಹೆಚ್ಚಿಸುವುದಕ್ಕೆ ಮತ್ತು ಶಿಕ್ಷಣವನ್ನು ಪ್ರಜಾತಂತ್ರೀಕರಿಸುವುದಕ್ಕೆ ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯ ವ್ಯವಸ್ಥೆಯನ್ನು ಆರಂಭಿಸಲಾಗಿದೆ.

ರಾಷ್ಟ್ರೀಯ ಶಿಕ್ಷಣ ನೀತಿ 1986

'The Open University system has been initiated in order to augment opportunities for higher education and as instrument of democratizing education.'

National Education Policy 1986

ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯವು ದೂರಶಿಕ್ಷಣ ಪದ್ಧತಿಯಲ್ಲಿ ಬಹುಮಾಧ್ಯಮಗಳನ್ನು ಉಪಯೋಗಿಸುತ್ತದೆ.
.....ವಿದ್ಯಾಕಾಂಕ್ಷಿಗಳನ್ನು ಜ್ಞಾನ ಸಂಪಾದನೆಗಾಗಿ ಕಲಿಕಾ ಕೇಂದ್ರಕ್ಕೆ ಕೊಂಡೊಯ್ಯುವ ಬದಲು, ಜ್ಞಾನ ಸಂಪತ್ತನ್ನು
ವಿದ್ಯೆ ಕಲಿಯುವವರ ಬಳಿ ಕೊಂಡೊಯ್ಯುವ ವಾಹಕವಾಗಿದೆ.

ಡಾ. ಕುಳಂದೈಸ್ವಾಮಿ

*'The Open University system makes use of Multimedia in distance education system.
..... it is vehicle which transports knowledge to the place of learners rather than transport to
the place of learning.'*

Dr. Kulanandai Swamy

ಸುವರ್ಣ ಕರ್ನಾಟಕ ವರ್ಷ 2006

ವಿಶ್ವ ಮಾನವ ಸಂದೇಶ

ಪ್ರತಿಯೊಂದು ಮಗುವು ಹುಟ್ಟುತ್ತಲೇ - ವಿಶ್ವಮಾನವ. ಬೆಳೆಯುತ್ತಾ ನಾವು ಅದನ್ನು 'ಅಲ್ಪ ಮಾನವ'ನನ್ನಾಗಿ ಮಾಡುತ್ತೇವೆ.
ಮತ್ತೆ ಅದನ್ನು 'ವಿಶ್ವಮಾನವ'ನನ್ನಾಗಿ ಮಾಡುವುದೇ ವಿದ್ಯೆಯ ಕರ್ತವ್ಯವಾಗಬೇಕು.

ಮನುಜ ಮತ, ವಿಶ್ವ ಪಥ, ಸರ್ವೋದಯ, ಸಮನ್ವಯ, ಪೂರ್ಣದೃಷ್ಟಿ ಈ ಪಂಚಮಂತ್ರ ಇನ್ನು ಮುಂದಿನ
ದೃಷ್ಟಿಯಾಗಬೇಕಾಗಿದೆ. ಅಂದರೆ, ನಮಗೆ ಇನ್ನು ಬೇಕಾದುದು ಆ ಮತ ಈ ಮತ ಅಲ್ಲ; ಮನುಜ ಮತ. ಆ ಪಥ ಈ ಪಥ ಅಲ್ಲ; ವಿಶ್ವ
ಪಥ. ಆ ಒಬ್ಬರ ಉದಯ ಮಾತ್ರವಲ್ಲ; ಸರ್ವರ ಸರ್ವಸ್ವರದ ಉದಯ. ಪರಸ್ಪರ ವಿಮುಖವಾಗಿ ಸಿಡಿದು ಹೋಗುವುದಲ್ಲ;
ಸಮನ್ವಯಗೊಳ್ಳುವುದು. ಸಂಕುಚಿತ ಮತದ ಆಂಶಿಕ ದೃಷ್ಟಿ ಅಲ್ಲ; ಭೌತಿಕ ಪಾರಮಾರ್ಥಿಕ ಎಂಬ ಭಿನ್ನದೃಷ್ಟಿ ಅಲ್ಲ; ಎಲ್ಲವನ್ನು
ಭಗವದ್ ದೃಷ್ಟಿಯಿಂದ ಕಾಣುವ ಪೂರ್ಣದೃಷ್ಟಿ.

ಕುವೆಂಪು

Gospel of Universal Man

Every Child, at birth, is the universal man. But, as it grows, we turn it into "a petty man".
It should be the function of education to turn it again into the enlightened "universal man".

The Religion of Humanity, the Universal Path, the Welfare of All, Reconciliation, the Integral
Vision- these *five mantras* should become View of the Future. In other words, what we want henceforth
is not this religion or that religion, but the Religion of Humanity ; not this path or that path, but the
Universal Path ; not the well-being of this individual or that individual, but the Welfare of All ; not
turning away and breaking off from one another, but reconciling and uniting in concord and
harmony ; and, above all, not the partial view of a narrow creed, not the dual outlook of the material
and the spiritual, but the Integral Vision of seeing all things with the eye of the Divine.

Kuvempu

Karnataka State Open University
Manasagangothri, Mysore- 570 006



ಕರ್ನಾಟಕ ರಾಜ್ಯ ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾನಿಲಯ
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COURSE IV

M.A. ECONOMICS **[Previous]**

Block 2



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M.A. ECONOMICS

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**UNIT -5 : PRIVATE AND PUBLIC MECHANISM FOR
ALLOCATING RESOURCES**

Structure

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Private and public mechanism for allocating resources.
- 5.3 Problems of allocating resources
- 5.4 Preference revelation and aggregating of preferences
- 5.5 Let us sum up
- 5.6 Key concepts
- 5.7 Typical questions

5.0 OBJECTIVES

Our main objective in this unit is to study the allocation of factors among end uses in the private sector of the economy. Next comes the relative size of the public and private sectors and the distribution of expenditures in the public sector. Although the tendency in recent years has been to give a great deal of attention to the private sector, we should also take keen interest in the public sector. One is tempted to describe the allocation of resources as providing for the satisfaction of public wants but this does not tell us much. We should therefore view this allocation of resources as that of securing necessary adjustments by the market and the various situations in which such adjustments are required and thus secure a more specific view of the nature of public goods. The ultimate allocational objective, of course, is the attainment of maximum social welfare. We all benefit from government activities and expenditures. We rely on governments to provide us. With such basic services as national defense, education, highways and mass transit and social programmes to maintain the incomes and welfare of the unemployed, the poor and the elderly. Governments are organised to exercise authority over the actions of persons who live together in a society and to provide and finance essential services. Individual preferences for public goods are greatly influenced by governments as an organisation of the society, they constitute the ultimate source of justification for governmental activities. The basic decisions concerning production of public goods and output levels must reflect the preference patterns of the people.

5.1 INTRODUCTION

The pricing mechanism of the market secures an optimal allocation of resources, provided that certain conditions are met.. These conditions are met reasonably well over wide areas of economic activity, so that the bulk of

the allocation function may be left to the forces of the market.. Here we are faced with the problem of how public policy can intervene to secure a more efficient resource allocation. Resources should be allocated among different uses in such a manner that the marginal utility in each use is the same and thus applicable in the marginal analysis of the intra public sector question as to Which public goods should be produced, It is applicable to exhaustive public expenditure, where resources are directly absorbed and to transfer government expenditure, where only re distribution of income and wealth takes place. Government provision of goods and services requires labour, equipment” buildings and land. The real cost of government goods and services is the value of private goods and services, is the value of private goods and services forgone. When citizens pay taxes, their capacity to purchase goods and services for their own exclusive use, such as automobiles, clothing, housing, cameras and dining out is reduced. The resources that are thereby diverted from private use are purchased or otherwise obtained by government. This allows government to provide citizens with those goods and services, such as roads, police and fire protection and national defense that are available for collective or common use by individuals. These goods and services are shared by all, they cannot be used by anyone citizen alone and exclusively. Other goods and services provided by government are limited in availability to certain groups, such as the aged or children, as is the case with social security pensions and schooling. Resources are said to be efficiently allocated when the well -being of anyone person can no longer be increased without harming another.

5.2 PRIVATE AND PUBLIC MECHANISM FOR ALLOCATING RESOURCES

In a democratic society, the desire of individuals is the justification for governmental provision of goods and the redistributive activities. Individuals as citizen -voters, as government executives, as bureaucrats are motivated by the desire of to fulfill their own preference schedules. These reflect self -interest in large measure, but also concern for the welfare of others for par-

ticular activities of government per se and for society. Government goods and services are supplied through political institutions, which are rules and procedures that have evolved over time, in given societies, for arriving at collective choices. Increases in government goods and services require decreased private use of resources. Government goods and services are usually made available without charge for their use and they are financed by compulsory payments, mainly taxes, that are levied on citizens and their activities. The distribution of the tax burden itself is determined through political interaction of citizens.

Institutional arrangements are needed to translate people's preferences and the costs of producing goods into actual economic activity and outcome. The free enterprise system comprises one set of such arrangements. However, economic decisions can also be made through the political process. Free enterprise and voluntary exchange are institutional arrangements to produce and distribute goods and services. People's preferences for goods are expressed through the force of market demand and the cost of the resources needed to produce the good'): is reflected in the concept of market supply. The notion of ideal output in the private sector is grounded in the concept of perfect competition, which implies an infinitely elastic demand for each of the products of any one firm and an infinitely elastic supply of each of the factors to that firm. If all those taking part in this perfectly competitive society act so as to maximise their satisfaction or returns, certain results follow when the system is in equilibrium.

We have noted repeatedly that budget determination involves a political rather than a market process. The purpose is to consider this political process more closely. How are the individual's views on fiscal matters expressed and how are they translated into political action. A person decides upon the amount of a private good he wishes at the prevailing price and buys it. This he cannot do with public good. The output of a public good and the tax price of this output, are decided by the government on the basis of overall preferences.

How do various voting rules work out and what is the role of parties

and coalitions. Does the decision process reflect the wishes of the public or does government impose its own will. Political parties have incentives to propose less than the efficient amount of government services when voters are better informed on costs than on benefits of those services. However vote-maximising behaviour also provides incentive for politicians to engage in implicit logrolling. This tends to result in more than the efficient amount of government spending. What built-in biases are there in budgetary decisions. Models of bureaucratic behaviour presume that bureaucrats attempt to maximise the size of their budgets. If they face no competition and no restraints from budgeting procedures, this leads to a tendency of oversupply of government output or inefficient production techniques. Special interest groups also influence political outcomes by seeking to increase government subsidies to their constituents that are financed by taxes on others.

Public goods are consumed by more than one person at a time and it is difficult to exclude people from enjoying the benefits of public goods because they have not paid for them. Private goods on the other hand, do not offer joint consumption. The consumption of a private good by one person makes impossible the consumption of it by another person. It is also relatively easy to exclude non payers from consumption of private goods. We can define the efficiency conditions for private goods and for public goods. For private goods the efficient amount exists when the market price is equal to both the marginal costs of production and the marginal benefits enjoyed by each consumer. For pure public goods, which must be simultaneously enjoyed by all consumers, efficiency requires that the sum of the marginal benefits people derive from the good be equal to its marginal cost.

Generally, we expect private markets to provide private goods and a political process to assure the supply of public goods. We don't count on private markets to adequately provide public goods, because we expect that in a private market there will be a tendency for people to attempt to be free riders for goods the benefits of which they cannot be denied. Private markets and voluntary exchange are relied upon to provide private goods, and sometimes they may be all that's needed to provide even pure public goods. How-

ever, when the number of people sharing a public good is large, there is no escaping the need for government. We do not expect to observe in the real world a perfectly efficient supply of private or public goods. We do not have perfectly competitive private markets, and government does not have perfect knowledge of people's preferences for public goods, nor can it calculate the specific tax shares needed to assure efficiency.

Our approach begins with the individual consumers who is the final beneficiary of public services and whose consumption of private goods is reduced when resources are transferred to the public sector. The key question is how preferences on the matter can be expressed and implemented. Decisions may be reached in the small group by a process of negotiation and bargaining. Each individual's contribution is sufficiently important to the individual and to others for them to enter into a bargaining process. Negotiation among the parties may lead to an agreement on what supply of social goods should be provided and on who contributes how much. In these small number cases some bargaining solution will be reached, although as noted before, the outcome may not be efficient. But such bargaining solutions are not feasible where large numbers are involved. Here the contribution of anyone individual acting alone is too small to make a difference and numbers are so large as to make negotiation unmanageable.

Individual preferences must be translated into budgetary decision through a political process involving the individuals preferences as recorded by voting and the response of these political parties or leaders to whom the voter delegates the final decision. Leaving the issue of delegation until later, we begin with a simplified setting of direct democracy i.e. a system where final decisions are made by referendum among individual voters. Voters know that the group decision reached by voting will be binding on them. Therefore they will vote so as to move the decision in a direction more compatible with their own tastes.

Differentiating between public and private goods gives us some insight into understanding what goods we expect to be provided by government through a political process and those we expect to be provided through

private markets by voluntary exchange. Goods exhibiting low degrees of exclusion and high degrees of jointness are most likely to be provided through government; those, which exhibit a high degree of exclusion and a low degree of jointness through private markets. Strictly public goods are consumed collectively, the benefits, indivisible in nature accrue to persons of the community as a group. Accordingly the individual may not realise that he benefits at all. Defense and administration of justice are examples of goods falling into the public sector category, meat and potatoes are examples of goods falling into the private sector category. It is important to recognise, however that government involvement in the provision of certain goods and services is not synonymous with government production of a good or service. Generally when we act through government, what we decide upon is a given level of service to be provided uniformly among some set of the population.

5.3 PROBLEMS OF ALLOCATING RESOURCES:

In the modern economies, the size of the government sector ranges between one-quarter and one-half of GNP. A major goal in the study of Public Economics is to analyse the economic role of government and the costs and benefits of allocating resources to government use as opposed to allowing private enterprise and households to use those resources. The economic case for a public sector to allocate resources may be developed in terms of the distribution and stabilization functions of an economic system. The allocative case for a public sector will focus on problems which cause partial failure in the efforts of the market to allocate resources and thus to produce a social optimum output. These include 1. Decreasing costs of production and imperfect market structure, 2. Zero marginal cost. - the polar extreme of decreasing production costs, 3. Joint consumption with non-exclusion, 4. Significant economic effects (externalities) not captured by the price systems and 5. Special supply phenomena which can cause failure in market efforts to allocate resources.

The pricing mechanism of the market secures optimal resources where

problems of allocation policy must be faced. To begin with, an occasion for adjustment arises where, for institutional reasons, the organisation of industry precludes free entry, so that allocation diverges from that obtained under purely competitive conditions. The second and more difficult problem of adjustment arises in the case of lumpiness of productive factors and of production processes that involve decreasing cost. Next we have situations where external economies and diseconomies are generated by the operation of particular individuals or firms. Other discrepancies may arise from differences between public and private risk, and again others from differences between public and private time preferences. We thus find a wide array of situations where the market mechanism involves varying degrees "of inefficiency in resource allocation -inefficiencies that arise collateral to the satisfaction of private wants. The existence of market imperfections must be allowed for in the determination of efficient budget policy, and budget policies may be used to remove them. Let us now turn to situations where the market mechanism fails altogether and where the divergence between the social and private product becomes all-inclusive. A primary difficulty arises because true preferences are unknown. Since, as we have noted, no one can be excluded from the benefits that result, consumers will not readily reveal their true preferences. The next difficulty arises even if we assume that the true preferences of all individuals are known. The difficulty arises because there is no single most efficient solution to the satisfaction of social wants or to the problem of supplying services that are consumed in equal amounts by all. A different type of intervention occurs when public policy aims at an allocation of resources, which deviates from that reflected by consumer sovereignty.

However it should be concluded that the supply to pure public goods should be entrusted in the hands of public sector. If the task is left in the hands of private sector, then the system would suffer from inefficiency on account of the following reasons. 1. Left to the market mechanism, even a pure public good would have to be priced. This would automatically involve the enforcement of principle of exclusion to its use. 2. There may be divergence between private cost and social costs of the products. The supply of

goods, therefore, would not be at the optimum level in the market, However, though desirable the state may not be able to provide all those goods, which have predominantly by public element in them for the following reasons, 1. The state may not have enough resources to undertake the supply of all goods. 2. The administrative machinery of the state may not be efficient enough to undertake the provision of all goods. 3. The efficiency in public undertaking is low as compared to the private undertakings. 4. The extent to which a government will choose to undertake the provision of public goods also depends upon political and social acceptability of the government policies.

Political parties have incentives to propose less than the efficient, amount of government services when voters are better informed on costs than on benefits of those services. However vote-maximizing behaviour also provides incentives for politicians to engage in implicit logrolling. This tends to result in more than the efficient amount of government spending. A major problem is how to conduct fiscal policy so that its major objects including allocation, distribution and stabilization aspects can be at the same time.

5.4 PREFERENCE REVELATION AND AGGREGATION OF PREFERENCES

Individual preference schedules for public goods are influenced partly by the same forces that affect the demand for private goods. Since many public goods convey some direct benefit to individuals as well as indivisible public benefit, those persons receiving the greatest direct gains will have greater preference. Other things equal. Since benefits do not accrue separately to individuals, externally obtained information is necessary if the individuals are to have meaningful preference schedules.

The problems involved in revealing societal allocational preferences through a democratic political process may be analysed. Given the distributional value judgments, which make these preferences effective, the political process functions to varying degrees of efficiency in implementing such preferences in the form of actual allocation. The ultimate allocational objective, of course, is the attainment of maximum social welfare. The Welfare Eco-

nomics allows for such a goal to be set in terms of public goods consumption. While the positive economics framework is concerned with the institutional decision making mechanism through which efforts can be made to attain such a goal. Thus positive economics deals with the reality of the decision making process, regardless of what the goals are or whether the welfare goals are ever fully attained.

The process of acquiring the necessary information is expensive and for each person there are many issues that are simply not of much interest. In other words, it is time to recognise that we don't care about all issues with equal intensity of preference. Voting systems can be designed to express our intensity of preferences. Yet another way of expressing our intensity of preference is to select others to do our voting. Politicians and political parties are a great convenience in that they do much of our voting for us. However, because a politician or political party must stand for a number of issues simultaneously, they also permit us to express the varying intensity of our concern for many issues.

As we know public goods are indivisible, unless particular preferences are identical with collective decisions. Individuals cannot obtain an optimal adjustment. An individual, as we have already understood, expresses his demand in accordance with his preferences and the tax cost, but this individual decision or preference may not agree with collective decision. If his preference does not agree with the collective decision, there is no adjustment that he can make that will improve his position.

The consumers who individually demand private type goods through the market are viewed here as demanding public type goods through the democratic political process. Partial market failure in allocative efforts leads to an acceptance of governmental allocational intervention despite a market oriented culture. Differences in the nature of public type economic goods such as the trait of joint consumption may require public sector allocation intervention if these goods are to be effectively supplied. However interpretation of the demand for public type goods creates problems of preference revelation that are unlike those experienced in the market sector of the

economy. Some of the difficulties encountered in revealing economic preferences in the absence of a market mechanism moreover some possible institutional improvements will be suggested to enhance the revelation of societal preference for public-type goods through a democratic political process.

For decision-making in governmental activities, however the unanimity rule is not acceptable and in fact is never employed for this purpose. Alternative procedure for voting are sometimes suggested as a more direct means of recognising the varying intensities of preferences. Plurality voting allows ranking of the various choices and determination of the rankings obtained by aggregating the preferences. Kenneth Arrow has provided additional insight into the problems involved in making societal decisions consistent with individual preferences through group voting in a democratic political process. The point method of voting unlike ordinary majority voting emphasizes the relative intensity of preferences among alternative budgetary policies. An approach in which the problems of individualistic choice and social welfare are viewed in terms of utility maximization under conditions of uncertainty and risk. A voting system based on unanimous consent would be pareto-efficient. That is, when all voters agree on a given course of action, we can assume that all will benefit or at least, that no one will be made worse off. But unanimous consent voting is not practical. Majority voting is the most popular decision making rule.

5.5 LET US SUM UP

Generally we expect private markets to provide private goods and a political process to assure the supply of public goods. We don't count on private markets to adequately provide public goods, because we expect that in a private market there will be a tendency for people to attempt to be free riders for goods the benefits of which they cannot be denied. The political process involves the activities of citizen voters, politicians, bureaucrats and special interest groups. We assume that people's public sector behaviour is governed by self-interest, and constrained by the costs of gathering informa-

tion.

5.6. KEY CONCEPTS

Public Finance Preference revelation Private goods and public goods

Bureaucracy

Political institutions Special interest groups Individual Preferences Logrolling

Majority Voting Free rider

Exclusion Principle Resource allocation

5.7 TYPICAL QUESTIONS

1. Explain the private and public mechanism for allocation of resources in the theory of public choice.
2. Discuss the various problems associated with the allocation of resources between private and public goods.
3. Examine the intensity of preference revelation and aggregation of preferences in community decision-making.

5.8 SUGGESTED READINGS:

1. Bernard .P.Herber (1988) : Modem Public Finance, Fifth edition Richard .D. Irwin. Inc. Homewood, Illinois.
2. David .N. Hyman (1990): Public Finance, Third edition, The Dryden Press, Chicago.
3. Richard.A. Murgrave and Peggy.B.Musgrave (1989) Public Finance in Theory and Practice, Fifth edition, McGraw Hill International edition, New York.

**UNIT: 6 VOTING SYSTEM ARROW'S IMPOSSIBILITY
THEOREM AN ECONOMIC THEORY OF
DEMOCRACY**

Structure

- 6.0 Objectives
- 6.1 Introduction
- 6.2 Voting systems
- 6.3 Arrow's impossibility theorem
- 6.4 An economic theory of democracy
- 6.5 Let us sum up
- 6.6 Key concepts
- 6.7 Typical questions
- 6.8 Suggested readings

6.0 OBJECTIVES:

Our main objective in this unit is to understand the political process, which involves more than just counting votes and deciding on the rules for reaching agreement. Agendas for Political action must be drawn up, alternative proposals must be placed before votes, and information on the costs and benefits of the alternatives must be made available. A voter's decision to vote depends on the benefits and costs of doing so, as well as on the probability that voting will help to achieve the anticipated benefits, There also may be benefits that the individual receives from voting that do not necessarily depend on whether the desired alternative is approved. One such benefit is the pleasure received from exercising the duties of being a citizen. The political process involves the activities of citizen-voters, politicians, bureaucrats and special interest groups. We assume that people's public sector behaviour is governed by self-interest and constrained by the costs of gathering information. How can people express the intensity of their preferences for various issues. Complicated systems of point voting would give people the opportunity to show that they are not equally interested in all issues. In a representative democracy using majority vote, the platforms and campaign promises of political parties and politicians can also allow us to express the strength of our feelings. The politicians who stands for that which we consider most important. Also, when the group voting is small ego Legislature, vote trading i.e. logrolling among politicians can act to transfer votes from uses of little concern to those of major interest.

6.1 INTRODUCTION.

Does voting and the political process result in a set of publicly supplied goods and services that is in harmony with the diverse preferences of individual citizens? A voting system based on unanimous consent would be pareto -efficient. That is, when all voters agree on a given course of action, we can assume that all will benefit or, at least that no one will be made worse off. But unanimous consent voting is not practical. Rather, it is majority voting

that is the most popular decision-making rule. Simple majority voting is a handy administrative device. It is easy to understand and it generally provides a clear choice from among alternative options. When applied to decisions concerning public goods, majority voting among people with single-peaked preferences produces results reflecting the wishes of the person with median preferences. When people's preferences are not single peaked, however, majority voting produces ambiguous results. From among several options all may be potential winners. The choice will be determined by the order in which the options are presented. Political equilibriums are influenced by politicians and bureaucrats. Models of political behaviour presume that political parties attempt to maximise votes. In cases where all voters have single-peaked preferences, this suggests that parties will tend to move to the median position to win elections. In cases where all voters do not vote, the median most-preferred outcome of all citizens could differ from the median most preferred outcome of all voters. Voters may choose not to vote because they believe that their votes will have no effect on the outcome of an election. The costs of voting might outweigh the expected benefits of doing so. Special interest groups also influence political outcomes by seeking to increase government subsidies to their constituents that are financed by taxes on others.

6.2 VOTING SYSTEMS

Public choice theorists have stressed the importance of information costs as a factor in understanding the behaviour of citizen voters, politicians, bureaucrats and special interest groups. Citizen-voters are not expected to be fully informed on all public matters, it's simply too expensive. Thus an advantage of representative democracy as opposed to a direct democracy is that citizen. Voters can reduce the number of issues upon which they must become knowledgeable. The relationship between voters and politicians is, of course, complex. But high information costs may partially explain why citizens are willing to leave many issues in the hands of elected. f representatives may decide to concentrate on but a few issues during a campaign.

The political process involves more than just counting votes and deciding on the rules for reaching agreement. Agendas for political action must be drawn up, alternative proposals must be placed before voters and information on the costs and benefits of the alternatives must be made available. Political parties act to propose alternatives to the electorate. In addition various special-interest groups apply pressure to political candidates and parties to support proposals favourable to their constituents.

These groups also disseminate information about the positions of various political candidates in the hope of persuading voters to vote in favour of alternatives that benefit the constituents of the special interest groups. Citizens operate through political institutions to pursue their interests. Our analysis examines political institutions and the behaviour of citizens, politicians and public officials as they interact through those institutions. The political process is very complex. It is relatively easy to establish that markets will fail to efficiently provide goods and services whose exchange results in externalities. But can government do a better job than the market. To answer this question requires analysis of the incentives of participants in the political process and of the costs of political interaction.

The cost of information also influences the relationship between elected officials and bureaucrats. Elected officials authorise and appropriate funds but they are not likely ('to become familiar with the specific details of many programmes. It is the departments and agencies of government that are responsible for administering approved projects. The bureaucrats become the experts in various programme areas and as a result they gain influence and power. There is the role of the special interest groups. The lobbying activities of trade associations, unions, political action committees etc are aimed at influencing legislation. Public choice theory recognizes the potential conflicts of interest that arise in a political setting. A person, or special interest group, may very well be in favour of a programme promising them net benefits but which for society as a whole creates costs in excess of benefits.

A voter's decision to vote depends on the benefits and costs of doing so, as well as on the probability that voting will help to achieve the anti-

pated benefits. There also may be benefits that the individual receives from voting that do not necessarily depend on whether the desired alternative is approved. One such benefit is the pleasure received from exercising the duties of being a citizen. Many citizens quite rationally believe that their votes will not make any difference in the outcome of an election. There is a high probability that, if any given citizen chooses not to bother to vote, the outcome of the election will be unaffected. Voters reason that the probability of their votes influencing the election will be close to zero when the number of voters is large.

6.3 ARROW'S IMPOSSIBILITY THEOREM

Kenneth Arrow has provided additional insight into the problems involved in making societal decisions consistent with individual preferences through group voting in a democratic political process. Although Arrow's observations pertain, in general, to the problems encountered under any democratic voting rule based on individualism, their most relevant application is to the majority voting rule which is the mainstay of western democracies. He argues that the following conditions must be met if a collective decision reached under majority voting conditions is to accurately reveal the individual economic preferences which constitute the effective social indifference curve (the social welfare function).

1. Social choices must be transitive (consistent). That is, a unique social ordering must exist which will yield a clear-act winning alternative regardless of the ordering sequence in which alternative choices are voted on. If policy x is preferred to policy y and policy y is preferred to policy z , then policy z cannot be preferred to policy x in the social welfare function. A unique social ordering must exist regardless of the manner in which individuals in the society order their alternative choices.

2. The social welfare function must be non perverse in the sense that an alternative policy which might otherwise have been chosen by the society

must not be /rejected because any individual has changed the relative ranking of that alternative. That is if policy z is moved upward in the rankings among alternative policies, without changing the relative rankings among the other alternatives. Policy z cannot move to a lower place in the rankings as a result of the initial change.

3. The rankings of the choices in the social welfare function between two alternatives must be independent of the rankings by individuals of other [alternatives which are irrelevant to the choice between the two alternatives. That is, the elimination of anyone alternative must not influence the ranking of the *I* other alternatives in the Social Welfare function. It is maintained by Arrow that L it is often impossible to make social or group decisions, which are consistent with individual preferences when a majority one of alternatives must not influence the ranking of the other alternatives in the social welfare function.

4. Voters must have free choices among all alternative policies.

5. Social choices must not be dictatorial. That is they must not be based solely on the preferences of one individual independent of the choices of other individuals. Social choices must not be imposed either from within or from outside the society must be able to vote freely among all alternative.

Table I: Examples of majority voting -individual preferences for alternative budget policies.

A. Results: Intransitive

Voter	Policy Alternatives		
	Preference 1	Preference 2	Preference 3
A	X	Y	Z
B	Y	Z	X
C	Z	X	Y

B. Results: Transitive

Voter	Policy Alternatives		
	Preference 1	Preference 2	Preference 3
A	X	Y	Z
B	Y	Z	X
C	Z	Y	X

The above tables illustrate a situation in which majority voting violates the set of conditions necessary for consumer sovereignty to be maintained in collective democratic decision making. Condition 1, the transitivity condition in particular is violated, leading to what is known as the impossibility theorem or voting paradox. Assume that three voters (A, B and C) are selecting among three budgetary policies (X, Y and Z). Policy alternative X represents a decision to build three public libraries; policy Y, a decision to build two libraries, and policy Z, a decision to build one library. Since a majority of the voters (in this example, two out of three) prefer policies X to Y, Y to Z and Z to X, the result is intransitive (inconsistent) in that there is no winner. In (~), this situation the sequence in which the voting occurs would determine the final outcome an obviously illogical result.

If we first pair policy X versus policy Y, X wins since two of the three voters prefer X to Y. If we then pair policy X versus policy Z, Z wins since two of three voters prefer Z to X. Thus a pairing sequence beginning with X versus Y results in Z as the ultimate winner. On the other hand, if we first pair policy Y versus policy Z, Y is favoured by two of three voters, but the subsequent pairing of Y and X finds X as the winner since it is preferred by two of three voters. Thus, a pairing sequence beginning with Y versus Z results in X as the ultimate winner. Finally an initial pairing of X versus Z finds Z winning over X, but the subsequent pairing of Z versus Y finds Y winning over Z each winning vote representing a two out of three voter preference. Thus a pairing sequence beginning with X versus Z result in Y as the ultimate

winner. To summarize, the outcome is arbitrary since either Z, X or Y will win depending on the ordering of the voting sequence. A close inspection of the above paradox reveals that intransitivity occurs because one voter C prefers the two extreme policies (2 for one library and X for three libraries) over the median or intermediate alternative, Y for two libraries. Yet this is an unlikely position for a voter to take, that is, to prefer three libraries as a second choice instead of two libraries, which is closer to the voter's top ranked choice of one library.

Although Arrow's requirements for rational collective decision making through majority voting are rigorous, his analyses nonetheless indicates some basic problems present in democratic political decision-making. However, one condition seems unduly rigorous, condition 3, which says that the elimination of anyone alternative policy shall not influence the ranking of the other alternative policies in the social welfare function. / There can be no interdependencies among alternative policies. Or, stated differently, the relative intensities of preference among voters for different policies cannot be a relevant consideration. Thus in the above example, the intensities of preferences for three, two or one library could not affect the outcome.

Consider another example i.e. one half of the community prefers improved / highways and streets to solve the traffic congestion in an urban area, while the other half prefers a government subsidized mass transportation scheme or system to meet the problem. Assume the cost to be equal for both traffic congestion solutions. If those who prefer the highly solution rank traffic congestion as a lower -priority program among various alternatives than those who prefer the mass transportation system, then the particular traffic congestion solution selected (provided money is to be spent for this purpose) should be the mass transportation system, those who prefer it exhibit higher relative intensities of preference. Condition 3, however essentially stipulates that a consideration of preference intensity is irrelevant. The Arrow approach thus tends to understate the intensity of desires among alternative policy choices. It is difficult for a system of social choice, which

ignores these basic preference considerations to interpret accurately individual demands expressed in the political process.

The Arrow theorem seems too pessimistic concerning the efficiency of the democratic political process though it does point out some weaknesses. This pessimism stems mainly from the two points of criticism, namely (1) the irrational voter depicted in the twin peaked preference function and (2) the assumption which precludes the ability of the democratic process to reveal voter's preference intensities among policy alternatives. The Arrow approach thus ignores the ranking and intensity /of desires among alternative choices. It is difficult for a system of social choice, which ignores these other considerations to effectively reveal true societal differences. In addition, the order in which voters are taken may influence the nature of the aggregate welfare function. For e.g. This would happen if the ordering of decisions between alternative policies an allowed interplay of strategy so that various voters could understate their true preferences for public goods.

6.4 AN ECONOMIC THEORY OF DEMOCRACY

A more realistic discussion can be made by discarding the assumption that individual voters participate directly in the decision process in a democracy. While the degree of direct participation differs among countries, it is only at the local level that fiscal decisions are made in referendum style. We have noted repeatedly that budget determination involves a political rather than a market process. The purpose is to consider the political process more closely. How are the individual's views on fiscal matters expressed and how are they translated into political action. How do various voting rules work and what is the role of political parties and coalitions. Does the decision process reflect the wishes of the public or does government impose its own will. What built -in -biases are there in budgetary decisions.

One explanation which is of particular interest to the economist draws analogy between the firm's competition for consumers in the market and the politician's competition for voters in the political arena. Just as economic

competition, under certain assumptions, guides producers to supply in line with preferences of consumers, so does the political competition under certain assumptions guide representatives to act in line with the interest of voters. This model is sketched by Prof. Joseph Schumpeter and developed in detail by Prof. Anthony Downs who offers an intriguing interpretation of the democratic process. In analogy to the economists' perception of "Homo Economics", it is assumed that political action is rational with the politicians and voters acting in their self-interest. The politician's objective is to maximise the net benefits which he derives from fiscal operation i.e. the excess of benefits he derives from government expenditures over his tax costs. Voters will thus cast their votes for those who will best represent their interest and politicians will offer programmes and support legislation which best meet the interest of their constituents. Those politicians who come closer by doing so will receive most votes and hence gain or retain political power. At the same time, there is a tendency towards maintaining status quo for eg Keeping old expenditure programmes unchanged and tax rates where they are and a substantial change in preferences of leadership may be needed to introduce new policies. Successful political leadership must take a position on combinations of issues so as to obtain a programme, which is acceptable to majority. Coalitions are formed which combine voters with congenial views on a set of issues.

A system of representative democracy has been examined and these features have been noted. Politicians may be thought of maximising votes by providing popular options thereby complying with the preferences of the voters. But politicians may also exert leadership by guiding such preferences. Fiscal representation is based on a structure of interest groups, reflecting a wide variety of characteristics and concerns. As applied to various fiscal policies, the voting process is simplest when deciding the size of the budget for a single social good and with a fixed tax assignment. The problem becomes more difficult if budget composition and tax structure are allowed to vary.

Critics of this model have pointed to a built-in-bias in the fiscal process. The budget is said to be over expanded due to bias in the working of majority rule and deficiencies in the voting process. This bias is said to be accentuated by the role of bureaucrats and politicians who serve their own Interest by expanding the budget.

Various devices may be applied to limit the size of the budget including constitutional amendments and legislative constituents. Classes and interest groups as well as individual voters enter into fiscal decision-making. According to the Marxist view the main division is between capital and labour and the struggle over fiscal issues may be seen as reflecting a struggle between these two classes. Viewed very broadly, the structure of fiscal interest groups becomes multi-dimensional, including groupings by income, industry, age and region with group formations frequently cutting across capital and labour.

Plurality and point voting lead to more representative outcomes, as intensity of preferences comes to be reflected. But use of voting strategy may interfere with efficient outcomes. Vote trading, if broadly based, may improve the efficiency of the outcome but logrolling between sub-sectors of interested parties leads to inefficiency. Through linkage of preferences, fiscal policy decisions are related to public policy determination at large. The afore-said model of the political process like the economic model of markets has its merits and also shortcomings. The perfection of democratic process, like everything in life, is a matter of degree. Its merits must be judged in /' comparison with the available alternatives. It will work better, more open and competitive political process, the more homogenous are the preference patterns of the voters.

6.5 LET US SUM UP

Majority voting may lead to arbitrary decisions, which will depend on the sequence in which issues are paired. Because preferences for social

goods are not revealed except in the small number case, budgetary determination based on a voting process is preferred. If preferences are single peaked, the median voter wins. Delegation of decision making to elected representatives introduces small-number bargaining at the final level of decision making, thereby helping to overcome the free-rider problem. Voting outcomes tend to be imperfect, but periodic free elections provide correction, requiring governmental policy to approximate the preference of the voters.

6.6 KEY CONCEPTS

Vote trading Plurality and point voting Political parties and coalitions
Budget determination Majority voting Democratic Process Social Welfare
Function Political leadership Collective decision making Fiscal interest groups

6.7 TYPICAL QUESTIONS

1. Describe the significance and implications of voting process in the theory of public choice.
2. Highlight the major constituents of Arrow's impossibility theorem.
3. Analyse critically the relevance of economic theory of democracy in the theory of public allocation.

6.8 SUGGESTED READINGS

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**UNIT 7: POLITICO-ECONOMIC INTERACTION-RENT
SEEKING A DIRECTLY UNPRODUCTIVE PROFIT
SEEKING (DUP) ACTIVITIES**

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Politico-economic interaction
- 7.3 Rent seeking and directly unproductive profit seeking
- 7.4 Let us sum up
- 7.5 Key concepts
- 7.6 Typical questions
- 7.7 Suggested readings

7.0 OBJECTIVES

Our main objective in this unit is to examine the political process, which involves the activities of citizen-voters, politicians, bureaucrats and special interest groups. Since the political process is at the heart of budget determination, fiscal theory must transgress the traditional bounds of economics and invade the adjacent domain of political theory. The purpose of this unit is to consider this political process more closely. How are fiscal decisions related to political decisions? Does the decision process reflect the wishes of the public or does government impose its own will? What built-in biases is there in budgetary decisions? Although traditionally these matters have been considered in the domain of political science rather than of economics both disciplines must be drawn upon in dealing with budget determination. Does voting and the political process result in a set of publicly supplied goods and services that is in harmony with the diverse preferences of individual citizens. A voting system based on unanimous consent would be pareto-efficient. That is, when all voters agree on a given course of action, we can assume that all will benefit or at least, that no one will be made worse off. But unanimous consent voting is not practical. Rather it is majority voting that is the most popular decision making rule. The political process involves more than just counting votes and deciding on the rules for reaching agreement. Agendas for political action must be drawn up, alternative proposals must be placed before voters and information on the costs and benefits of the alternatives must be made available.

7.1 INTRODUCTION

In political choice there should exist a means of comparing economic benefits and costs over a range of alternative budget policies and over a period of time. Moreover, the basic theory of the demand and supply of public goods and the political decision making process which response to these demand and supply forces, should also consider the means of financ-

ing these goods. Thus various tax-sharing schemes are highly relevant to the analysis. Furthermore, it is important to recognise that, a considerable decision making costs usually are incurred in reaching collective decisions in the public sector. The political process comprises the specific political institutions of a given community and the behaviour of politicians, Special-interest groups and Bureaucrats. Political parties act to propose alternatives to the electorate. In addition various special interest groups apply pressure to political candidates and parties to support proposals favorable to their constituents. These groups also disseminate information about the positions of various political candidates in the hope of persuading voters to vote in favour of alternatives that benefit the constituents of the special interest groups. Finally there is a cadre of bureaucrats career public employees not directly associated with political parties or special interest groups that also have incentives to influence the outcomes of political interaction. These bureaucrats also provide information to politicians and voters that could influence the results of elections. To understand the results of political interaction therefore requires a look into the incentives and behaviour of these through these three groups and their influence on voters. A system of representative democracy has been examined and these features have been noted. Classes and interest groups as well as individual voters enter into fiscal decision making.

7.2 POLITICO -ECONOMIC INTERACTION

Public choice theory recognises the potential conflicts of interest that arise in a political setting. A person, or special interest group, may very well be in favour of a programme promising them net benefits but which for society as a whole creates costs in excess of benefits. Politicians may favour programmes that concentrate significant benefits on special groups but which spread taxes as indirectly as possible over wide groups of people. And bureaucrats may have a tendency to design programmes with visible and immediate benefits rather than larger intangibles and distant benefits.

The preceding discussion views the democratic process as a mechanism by which, individual preferences are translated into group decisions. The critique of the democratic model, derives largely from an analysis of the behaviour of single individuals, whether they are voters, officials or politicians. An alternative approach emphasizes that individual action is constrained by membership in classes and groups, so that the fiscal process is seen as a matter of group interaction. Such an alternative approach is in line with the Marxist view, whereby the state (prior to the revolution) is to be seen as an instrument by which the ruling (capitalist) class exploits the subjugated (working) class. Actions of the state must be interpreted as a part of the class struggle, which transcends the political as well as the individual sphere of social relations. The view of fiscal politics reflected in the Marxist framework in which the social process is seen in terms of class struggle. It is not surprising, then, that tax and expenditure decisions will be a major instrument of that struggle. Dissatisfaction with taxation has indeed been a major factor in the history of revolutions and redistributive fiscal measures have to a degree expropriated the capitalist class. Indeed the rise of the modern welfare state, with its emphasis on transfers and progressive taxation, has placed the public budget at the hub of the social system. The recent shift of political attitudes and critique of the welfare state in turn have focused on a critique of its fiscal components.

Special interest groups are lobbies that seek to increase government expenditures that benefit their constituents. They differ from political parties in that their leaders do not actually run for political office. They do, however, seek to put pressure on political candidates, bureaucrats and ultimately, on voters to support issues that benefit the members of their groups. Special interest groups can apply pressure to politicians by ~ threatening to tell their constituents to vote against them. They can also make campaign contributions to politicians who support their positions and finance advertisements against candidates who do not support their interests. Special interest groups exist to promote policies favourable to workers, particular industries, regions, racial minorities, ethnic groups, environmental preservation and tax

payers in general. Many of these special interest groups have used their power to influence the votes of those who are not members or direct beneficiaries of their efforts. In effect, special interest groups in modern democracies often campaign with as much zeal and actual expenditure of money and resources as do the political candidates themselves.

By offering a well-organised reflection of voter concerns, interest groups can make a constructive contribution. But they also distort. Some groups are organised more easily than others, and some have more financial resources to press their views; and automatic development of a neatly balanced structure of countervailing power cannot be relied upon. It is thus important for a public policy to develop an institutional setting in which a more balanced representation of group interests prevails. However this may be, a realistic view of the fiscal system must take account of the strategic role of multiple interest groups, economic, demographic and regional. A positive theory of fiscal behaviour centered on the interaction of interest groups and their impact on fiscal institutions and decisions may well be more realistic than those based on preferences of individual voters or on their disregard by self-interested bureaucrats. Because preferences for social goods are not revealed except in the small-number case, budgetary determination based on a voting process is needed. Viewed more broadly, the structure of fiscal interest groups becomes multi-dimensional, including groupings by income, industry, age and region with group formations frequently cutting across capital and labour.

Persons are often members of more than one special interest groups. For ego A person could be a member of an occupational pressure group and of a group that / supports regional growth. This person could spend money and effort as a member of her occupational pressure group in ways that result in increases in the costs of obtaining the benefits desired for her special interest in regional growth. In effect, the activities of various special interest groups often result in both taxes and subsidies for their constituents. Many persons could be just as well off if both their taxes and subsidies from each pressure group were reduced in equal amounts. If the effect of these taxes

and subsidies cancel out, members of the various special interest groups will not be harmed. But because taxes and subsidies to particular activities result in efficiency losses, there will be net gains from reducing taxes and subsidies. Social action reflects the interests of particular individuals or of subgroups of individuals with similar interests. The economic system is designed to maximise individual satisfactions. Although this maximisation can largely be achieved through the market, a political process is needed when it comes to the provision of social goods and allowance for externalities. But group action through political process is required to provide social goods and this provision aims at satisfaction of individual preferences. Individual interests either coincide with group interests or the latter are given priority where a conflict arises. There exists a community interest as such an interest which is attributable to the community as a whole and which does not involve a mere addition of individual interests generated by and pertain to the welfare of the group as a whole.

The establishment of a permanent government also implies the development of a bureaucracy that is in charge of implementing collective choices made through political institutions. The bureaucracy itself influences the actual delivery of services and the efficiency with which such services can be produced. Insofar as bureaucrats influence the cost of producing public goods, their behaviour is an important determinant of the actual terms on which such goods can be produced and offered to citizens. In other words, bureaucrats influence the terms of supply of public goods and thus influence the, resulting political equilibrium. A basic problem exists in measuring the efficiency of production by bureaucrats. In most cases, the output produced is neither easily quantifiable into units nor easily sold for profit in markets. Therefore it is difficult to determine, whether government bureaus produce their output at minimum possible cost. For a private firm competing with other firms producing a similar output, such information is rapidly made available to owners through the firm's profit and loss statement. Bureaucrats do not directly own the inputs they use for production. Funding comes from an external source

and there are rarely any net financial gains to bureaucrats who produce efficiently. Among the most significant contributions by economists who have analysed bureaucracy in recent years is the work of William Niskanen. He has argued that bureaucrats seek to maximise the power associated with holding public office. The implication of Niskanen's analysis is that attempts by bureaucrats to maximise their budgets lead to a general extension of the government sector, in excess of the efficient level of output.

7.3 RENT SEEKING AND DIRECTLY UNPRODUCTIVE PROFIT SEEKING (DUP) ACTIVITIES

Economic rents are earnings from the use of resources that exceed the opportunity costs of those resources. Those who can earn economic rents therefore obtain more income from the use of their resources than would be possible were they to employ those resources in the next best use. Economic rents or profits, in markets act as a signal to other entrepreneurs to shift their resources to the rent-generating activity. For example If investors observe that economic rents are possible in the computer business, they will withdraw their funds from alternative investments so that they can be used in the production of computers. The existence of government provides a temptation to many to use the power of government to create rents. Governments can create rents for certain groups by establishing property rights to engage in certain activities. For example Government power can be used to grant exclusive licenses, franchises, or permits to purchase particular goods. Property rights created in this way usually restrict entry into certain activities either for buyers or sellers. This produces rents by creating artificial scarcities or surpluses. For example members of a certain occupational group might convince government authorities to restrict entry into that profession by establishing overly high standards. This will raise the price of service thereby increasing the income of those fortunate enough to be in the protected profession.

The notion of rent seeking was formalized by Anne Krueger in 1974. In her paper /she has focused almost exclusively on the analytics of rent seeking stressing its potential significance in international and trade theory

and other areas. She suggested that annual losses in India due to rent seeking induced by a system of price and quantity controls account for around 7 per cent of GNP. Some economists argue that the cost of rent seeking is much more than 7% calculated by Krueger and some put it to be between 30 percent to 45 percent. The main sources of rent seeking induced are the system of price controls, and rationing in goods and financial markets which appear ~ more important in terms of rent seeking costs than the quantity controls in foreign trade. In practice the rent seeking process is more complex. Some rents are allocated in ways which are largely unaffected by rent seeking activity. Over installation of capacity or, excess labour hiring utilised for rent seeking are thus to be thought as welfare costs of ~ excess investment and labour use in rent seeking firms.

In general, the kind of government favours sought by rent seekers are those that serve to raise or lower the prices of certain goods or services, thereby transferring income to those persons who enjoy the government granted rights. The time, effort, - legal fees and other resources devoted to obtaining these favoured rights are the social - costs of rent seeking. These costs are wasteful because they produce no useful good or service, merely serving to increase the income of some at the expense of others. Not all those who engage in rent -seeking activities necessarily will gain rents from government favours persons compete for rents. The sum of the resources expended actually could offset the gains received. For ego the profits earned by government sanctioned monopolies merely could reflect the value of resources that all monopolies spend in obtaining special favours. These social costs must be added to the social costs resulting from price distortions caused by the impact of government intervention in ~ markets. For ego the lobbying expenses of special interest groups engaging in rent seeking can be considered a social cost of political interaction. Measurement of the rent-granting activities of government is a difficult task. The government budget does ““ not attempt to measure rent-granting activity, except for a few direct transfer programmes. Other rents granted through the indirect effects of government

actions on the prices of goods and services never appear in the accounts of government expenditures. Some attempts have been made to measure the social costs of rent seeking in various industries and in some nations.

Directly Unproductive Profit seeking (DUP) activities are defined as ways making a profit (i.e. income) by undertaking activities, which are directly (i.e. immediately in their primary impact) unproductive in the sense that things produce pecuniary returns but do not produce goods or services that enter a conventional utility function or inputs into such goods and services. In recent years economists have increasingly turned to a (theoretical analysis of phenomena such as lobbying for protection, competing for a share of industrial or import licenses, inducing legislatures to and monopolistic barriers to domestic entry etc. Thus forge benefit seeking lobbying, tariff evasion and premium seeking for given import licenses are all privately profitable activities. However, their direct output is simply zero in terms of the flow of goods and services.

When markets fail to achieve efficiency does government intervention result in a net gain. There is no way to answer this question without appealing to the facts. Unfortunately obtaining the data necessary for a definitive answer is difficult. This has demonstrated that incentives faced by bureaucrats and politicians that re-distribute income to special interest groups. Often policies that gain political approval do not achieve efficient output of public goods.

Krueger's (1974) analysis of what she christened 'rent seeking activities relates to a sub set of the broad class of what are defined here as DUP activities. Her formal theoretical analysis is concerned with a welfare comparison between import licenses quotas with attendant premium seeking lobbying activity to earn the premia on these license vis-à-vis equivalent tariffs, which were explicitly assumed not to attract any seeking activity. Thus her focus is exclusively on licensing quantity restrictions and the rent thereon and her rent seeking activities exclude from their scope other DUP activities.

For ego Price distortion triggered DUP activities, or distortion triggering DUP activities. Models of bureaucratic behaviour presume that bureaucrats attempt to maximise the size of their budgets. If they face no competition and no restraints from budgeting procedures, this leads to a tendency of supply of government output or inefficient production techniques. Special interest groups also influence political outcomes by seeking to increase government subsidies to their constituents that are financed by taxes on others.

From the view point of the analysis of the welfare consequences of DUP activities evidently the most fruitful theory informed, taxonomy must build on the distinction between distorted (or sub-optimal) and non-distorted (for optimal) situations. Thus a DUP activity which use resources in the context of a distortion may be paradoxically welfare improving, whereas a similar DUP activity which destroys a distortion and achieves a first best, optimal outcome may be welfare worsening. The world is distortion free except for the distortions with which DUP activity in question is related in an essential way. In Krueger's model there is distortion in place when directly unproductive premium seeking is introduced but there are no other distortions. These DUP activities are wholly related to governmental policies involving changing these policies or evading them. However, they can be government free or exclusively private. There is a distinction between activities that utilise real resources directly and those that do not. For while pure transfers / bribes are often supposed to be resource free, they are not finally a distinction between legal and illegal activities may be made. Both belong to some category except than the latter are socially disappropriated. The diversion of resources from directly productive to directly unproductive activities when undertaken in the context of initially distorted situations is fundamentally different from such diversion occurring from a first-best situation and hence must represent a social loss as well, whereas in the former case it is occurring in a second best situation and hence need not represent a social loss but may will be beneficial.

7.4 LET US SUM UP

The prevalence of representative government in all democratic nations is best explained by an effort to economize on political transaction costs. There are losses in efficiency stemming from programmes that re-distribute income to special interest groups. Policy interventions and controls in India are quite strange and unusual to people in western economies. If import licenses are allowed on the basis of need and government jobs pay higher wages based on qualification over indulgence in investment on capacity by investors and individuals invest on education for government become obvious. Evaluating the cost of rent seeking in view of its highly enormous nature and also its diversity.

7.5 KEY CONCEPTS:

Politico -Eco interaction	Externalities
Economic rents	Bureaucracy
Democratic process	Property rights
Public Choice	Social costs
Welfare State	First -best situation

7.6 TYPICAL QUESTIONS

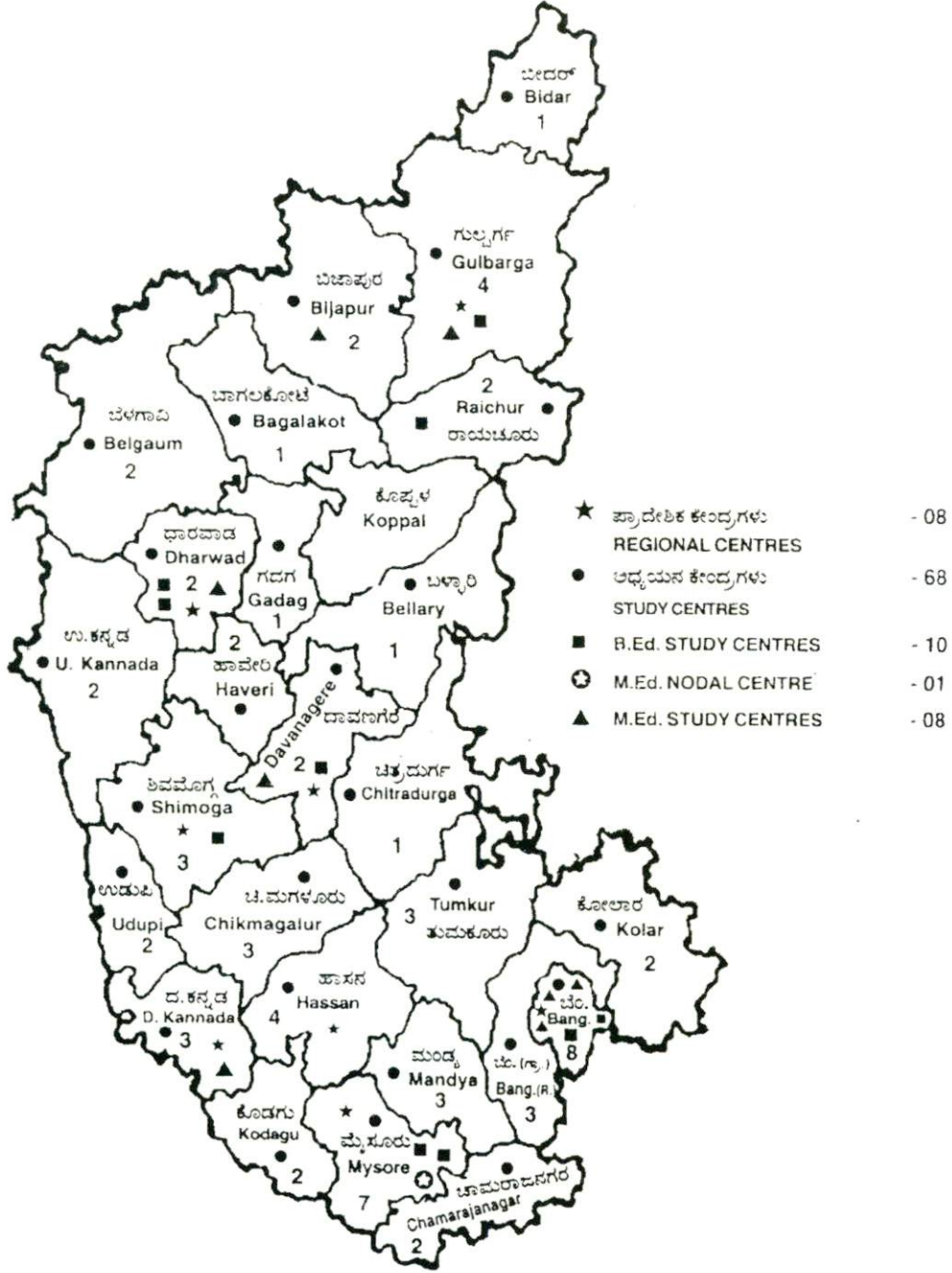
1. Critically evaluate the significance of politico -economic interaction in the theory of public choice.
2. Examine the relevance of rent -seeking and directly unproductive profit seeking (DUP) activities to India.

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ಕರ್ನಾಟಕ ರಾಜ್ಯ ಮುಕ್ತ ವಿಶ್ವವಿದ್ಯಾಲಯದ ಪ್ರಾದೇಶಿಕ ಹಾಗೂ ಅಧ್ಯಯನ ಕೇಂದ್ರಗಳು
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(ಸಮೂಹಿಸಿರುವ ಅಂಕಿ - ಜಿಲ್ಲೆಯಲ್ಲಿರುವ ಒಟ್ಟು ಅಧ್ಯಯನ ಕೇಂದ್ರಗಳ ಸಂಖ್ಯೆಯನ್ನು ಸೂಚಿಸುತ್ತದೆ.)
(The Number indicate the total number of study Centres existing in that districts.)

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