

# Politics and redistribution

EC3060 Economics of Policy Issues

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Question:

**How can political processes  
affect redistribution of income  
or wealth?**

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- Voting and redistribution
  - **Political behaviour and public policy**
  - Public policy and rent-seeking behaviour
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# Political Behaviour and Public Policy

- **Principal-agent** problem that can arise between voters (the principal) and political decision makers (the agent)
- Question: How does the **principal-agent** problem affect **public policy**?

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# The public interest and special interest

- When is there a principal-agent problem??
- When the **personal** objectives of political decision makers differ from the public policies sought by voters

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**What is the personal interest of politicians???**

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# What is the personal interest of politicians???

- To win the elections!
- Ever heard of an unemployed politician??

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- To win elections a politicians require
    - support of voters
    - money
  
  - The money is needed to finance the expenses of a political campaign
    - Personal interest of the politician is to have enough money for the campaign
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- The need of money can lead political candidates to accept **campaign contributions** from **special-interest groups** who seek public policies that are **not** in the public interest

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# What is the public interest?

- Median voter's interest?
    - Majority/minority
  
  - Public interest when there is consensus among voters?
    - Informational problems
  
  - Social welfare function?
    - Choice of the social welfare function. But can we reach consensus?
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# What is **not** public interest then?

- It is not in the public interest for political decision makers
  - to provide **discriminatory special** benefits for groups
  - when at the same time the policies that benefit the interest groups impose **losses** on the society at large

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# Objectives of interest groups

- Interest groups have narrow self-interest objectives
  - Sometimes they can be broad social objectives
  - Or the objectives might be controversial

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# Collective action

- Interest groups are engaged in collective action
- They might be subject to free-riding behaviour in contributions by members

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- Broad interest groups can offer
    - Votes
    - Money
    - both
  
  - Narrowly based interest groups can offer
    - Money
    - Personal favours
  
  - Political effectiveness of the interest group depends on its ability to overcome the free riding problems
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# Political decisions as a source of rents

- **Rents:** benefits for narrow special-interest group from political decisions
- **Rent-seeking:** incentive to obtain and protect rents by influencing public policy

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# An implicit contract

- Special interest groups seek rents from political favours
- The pay for the rents with contributions
- Politicians need contributions to win elections
- The politicians who accept special interest money enter an **implicit** contract to provide special interest benefits or rents



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- The interests of the special group differ from the broad public interest
  - By accepting special interest money, politicians compromise the public interest
  - Principal-agent problem between **political decision makers and voters**

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How can we solve the principal-agent problem?

■ **Incentives!**

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# 1. The voters

- The principal (voters) can design an incentive mechanism that leads agents (the political representatives) to internalize the interests of the principal
- There are however various problems

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## a) The size of the group and collective action

- Under representative democracy, smaller groups can be more effective politically than larger groups
  - in overcoming free-rider problems
  - more peer pressure to contribute to the common objective
- Under representative democracy , voters can be disadvantaged in being too large a group

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## b) Group size and the size of stake

- Members of special interest groups tend to have large stakes in the outcome of political decisions because their personal incomes are at stake
- Individual taxpayers face numerous special interest groups and have small stakes
  - Stakes are smaller because the public policy sought by one special interest group deprives voters of a small part of their incomes/ adds a small part to the excess burden of taxation

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- The attention of individual voters in resisting special-interest groups is more dispersed and diffuse
  - The relative size of the stake gives the special interest group a political advantage over voters in influencing public-policy decisions.

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## c) Disciplining through elections

- Voters can use elections to discipline politicians
- Political incumbents can be replaced in elections by political opponents
- Voters take a retroactive view
- Voters look back at the past performance of the incumbent

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## d) Rational ignorance

- Information about political behaviour is costly to acquire
- Individual voters might not be well informed about the behaviour of their elective representative



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## e) Free-riding in monitoring politicians

- Monitoring political behaviour is a public good
- A free-rider problem arises if individuals rely on other taxpayers to take the time to provide the public good benefit of monitoring politicians

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## f) The number of policy issues and the number of candidates

- There are more policy questions than there are candidates
  - Voters may be unable to find a candidate who reflects their preferences on every policy question
  - In elections one or two issues become focal points of attention
  - The remaining issues introduce opportunities for exchanges between political decision makers and special-interest groups
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## g) The decisions whether to vote

- What is the weight of a single vote?

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## g) The decisions whether to vote

- What is the weight of a single vote?
- Not much...
- The likelihood of any one person's vote making a difference in an election is small when there are millions of voters

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- The act of voting as been described as irrational
    - The personal benefit from voting is less than the personal cost of taking the time to vote
  - Personal values – rather than cost/benefit calculations – appear to explain why people vote

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## Some strategic considerations about voting...

- The number of people who vote depends on the number of people who are expected to vote.
- Reluctance of voters to vote diminishes the source of political advantage of voters

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## h) Term limits

- Term limits set bounds on the time the politician can spend in office
- New political representatives often idealistically seek the public interest (**Thomas-a-Beckett effect**)
- After some time in office, the **Thomas-a-Beckett** effect disappears

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## i) The press

- A biased press lacks the credibility among voters and cannot perform the task of providing **low-cost information** that voters can rely upon to make informed voting decisions



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## 2. Politicians

- Let's consider the problems that politicians face

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## a) Voter support and special interest money

- Political candidates need money for political advertising
  - Personal wealth
  - Donations with no strings attached
  - Special interest groups
- Political advertising is needed to communicate a candidate's position on different issues

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- The principal-agent structure of representative democracy is inverted if **money spent on political advertising convinces voters how they should vote.**
  
  - **Voters should be the principals!**
    - Voter should express their preferences about taxation and public spending through the political process

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## b) The duration of political benefits

- The time horizon of politicians when considering political support may not extend beyond the time of the next elections
- Politicians might prefer the benefits from political decision not extend much beyond the next election
- Why??

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- The time horizon of politicians when considering political support may not extend beyond the time of the next elections
- Politicians might prefer the benefits from political decision not extend much beyond the next election
- Why?? There may be no need for the beneficiaries to come back in the future to seek political favours

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## c) Comparison between politicians not seeking re-election and politicians who are seeking re-election

- There is a systematic difference:
  - Politicians who are not seeking re-election are more likely to take positions in the public interest than political incumbents seeking re-election.

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## d) The principled politician's dilemma

- The circumstances that make campaign contribution a necessity of political life define a **prisoners' dilemma**
- **Principled** politicians might prefer to contest political office **without accepting money** from special interests.

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- Principled politicians would wish to enter a binding agreement with political opponents that no candidate will accept special interest money. Say that this would bring the outcome (3,3)
  - A candidate that fails to honour the agreement and takes special interest money will get 4, while the opponent will get 1.
  - If both candidates default and accept the special interest money, the outcome will be (2,2)

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- Legal restrictions on political contributions are attempts to resolve the prisoners' dilemma facing political candidates and to avoid political influence by special interest groups.

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## e) Public finance for political expenses

- Political candidates or parties are often provided with **publicly financed** grants to cover political expenses
- If **public finance** is the **only source** of political funds, then the **prisoners' dilemma is solved**

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- One form of public finance of political expenses is **matching** public grants for private money received
  - Private money is necessary for receiving public money

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- Alternative policy: public finance on the basis of **votes received** in the last election.
    - This should reinforce the benefits of appealing to voters
  
  - But...
    - What if money buys votes through political advertising?
    - Barriers to new parties!

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# Compromises

- Politicians have to compromise between
  - Public interest
  - Special interest
- **The compromises can be expressed as choice of public policy to maximize political support**

# Political support, S

- Political support depends on the *utilities* of the  $n$  groups in the population

$$S = f(U_1, U_2, U_3, \dots, U_n)$$

- The higher the benefit for a group from a candidate's policies, the greater is the group's political support

$$\frac{\delta S}{\delta U_i} > 0$$

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# Example

- Consider a special interest groups seeking for lax environmental regulation
- Social welfare is maximized when the environmental externality is efficiently resolved
- Suppose that the political decision maker chooses to allow laxer environmental standards in order to get maximize political support

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- There exists a trade-off between environmental standards and benefits to a special interest group

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- Along each of the curves, political support is constant
  - Political support increases when
    - The level of pollution decreases because this pleases voters
    - When industry rents increase because this pleases the special interest group.

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- Objective of the political decision maker is to maximize political support by achieving the highest political support curve

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- The political response to the change in the public interest in environmental standards provides “something to everybody”.
  - The public interest is better served by more stringent environmental standards (point 3)
  - The industry is allowed a greater deviation from the public interest