

## I. Social Economics meets Political Economy

- A. Culture is for the most part neglected by neoclassical economics.
- i. It is neglected for several reasons including the specialization in social science that occurred in the late nineteenth and early twentieth century and the fact that "tastes" are usually simply assumed to exist in a relatively general form and used for all manner of analysis.
  - ii. The idea that some aspects of "tastes" may be influenced by culture was left behind as the more general or universal results were pursued by economic theorists and taught in micro economic and public economic classes.
    - a. In other cases, simplifying assumptions were made to produce mathematical structures with clear implications that could be tested, as with the Cobb-Douglas and CES utility and production functions.
    - b. Culture could be implicitly accounted for in empirical work by choosing one's samples: specific countries, regions, etc could be focused on or "fixed effects" could be used to "account" for cultural and "other" variations among regions, states, countries etc.
  - iii. The fact that "fixed effects" (regional "dummie" variables) are often statistically significant and account for much or most of the fit of international and disaggregated national studies suggest that culture matters, but does not really say how and was not a focus of attention until after 2000, and then mostly in international development empirical research.
  - iv. A theoretical avenue for including culture and other factors that might influence tastes/preferences in economic models was introduced by Stigler and Becker (1977) in their *De Gustibus Non Est Disupandum* paper in the AER, but it was not taken up for this purpose. It has, however, been used for many related purposes since then and by now has over 5K Google cites.

- B. This changed in the 1990s when books from influential writers such as Fukuyama (1995, *The social virtues and the creation of prosperity*) and Putnam (2000, *Bowling Alone, the Collapse and Revival of American Community*) brought ideas from sociology and ethics back to the attention of economists.
- i. This is not to say that no economists wrote about culture, ethics, or social capital, it is simply to say that those books somehow affected the way a broad cross section of economists thought about economic decision making and possibilities.
  - ii. There were, for example, books by Allen Buchanan (1985), James Buchanan (1991, *The Economics and the Ethics of Constitutional Order*; 1997, *Ethics and Economic Progress*).
  - iii. Congleton's (1989) analysis of status seeking discusses how status games vary among subcultures and his (1991) paper demonstrated that a work ethic could improve the performance of organizations.
  - iv. Ethical issues and ideas associated with social capital had also been previously mentioned by prominent economists such as Arrow (1972).

*Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.*

*(K. A. Arrow [1972] "Gifts and Exchanges," *Philosophy and Public Affairs* I:372.)*

and Hayek (1979)

*They held an ethos that esteemed the prudent man, the good husbandman and provider who looked after the future of his family and his business by building up capital, guided less by the desire to be able to consume much than by the wish to be regarded as successful by his fellows who pursued similar aims.*

*(F. A. Hayek [1979/2011- 03-21]. *Law, Legislation and Liberty, Volume 3: The Political Order of a Free People* [pp. 164–165]). University of Chicago Press; Kindle Edition.]*

- C. However, general economic interest in social capital and trust took off with the empirical studies of Knack and Keefer (1997) and Knack and Zak (2001), which should that cultural variations across countries could account for differences in the extent and rate of economic development..
- i. Knack (1999) had previously shown that it could account for differences in the quality of governance. in a World Bank report.
  - ii. Their work and presumably World Bank support for additional research generated an explosion of research on the effects of various aspects of culture on the extent and rate of economic development.
  - iii. Their results were not undisputed, but have held up fairly well..
- D. However, it is fair to say that little of this research has made its way into microeconomics or public economics text books.
- E. This lecture attempts to explore some of the implications of culture for public economics and for public choice. It also discusses how ideas such as trust and ethical dispositions can be brought into (neoclassical) public choice models.

## II. Culture and the Median Voter

- A. There are a wide range of cultural differences that can affect the median voter's demand for public services:
- i. Differences in ideas about the good life may affect voter demands for policies that subsidize operas, bicycle paths, electric cars, golf courses, sports arenas, and pedestrian shopping streets.

- ii. Differences in opinions about or the reality of the trustworthiness of governing institutions may affect the extent to which voters are prepared to delegate responsibility to government for various types of programs.
 

The more trustworthy governments and government official are, the more authority may be safely delegated to them.
- iii. Differences in the assessments of the relative trustworthiness of governments and markets would also affect the extent to which market regulations are demanded.
  - a. If neither are trustworthy, demands for regulation may be very limited, because voters might believe that they would simply (ala Stigler 1971) be used to extract surplus from consumers.
  - b. If markets are deemed more trustworthy than governments, then relatively little regulation would be demanded--because it is unnecessary and because it might not be well conceived or enforced.
  - c. If governments are deemed more trustworthy than markets, than a good deal of regulation might be considered necessary, because of problems of fraud, cartels, and monopolies.
- iv. Note that these demands are not quite the same as "ideologically" driven demands, although they may be related to an individual's ideology both because ideologies include theories about how the world operates and about how to evaluate the merits of alternative policies.

## III. Culture and Interest Groups

- A. Much the same can be said about interest group demands.
- i. Culture may influence the kinds of services lobbied for, the kinds of tax breaks lobbied for, and the relative success of such lobbying campaigns.
  - ii. For example, the churches granted tax privileges would vary with culture as would popular support or resistance to such privileges.
- B. Culture also affects the extent to which groups can form and lobby for favorable policies.

- i. Some of this is discussed in Congleton (1991, J Pub E) which shows differences between the rent seeking efforts of economic and ideological interest groups and in Congleton(2015, PC) which shows how Olson's model can be extended to take account of internalized norms associated with various cultures..
- ii. Groups are easier to form if they have internalized ethical dispositions of conditional cooperation or if persons have an internalized work ethic, or tend to be rule-following, etc.
- iii. Politicians, in contrast, will be easier to influence or bribe if they have mainly pragmatic, rather than moral or ideological interests in their offices.
- iv. *As an exercise, illustrate how culture can generate all of the above effects using diagrams and/or mathematical models of the sort previously developed in class.*
- v. *(Some of these illustrations may already have been undertaken in class.)*

**IV. An Illustration: Ethics and Agency Problems in Government**

- A. The mere creation of a law-enforcing organization or government does not assure that all persons adhere to the law. The manner and extent to which laws are enforced also matter. It is law enforcement, rather than the law itself, that ultimately creates the incentives that reduce or solve social dilemmas. Law-enforcing agencies may more or less energetically enforce the laws of a given community, whether customary, common, or statutory.
- B. Law enforcing responsibilities are often divided among separate policing, judicial, and punishment agencies, each of which is staffed by various teams assigned specific tasks. The problem of shirking is a problem for all such teams because the productivity of individuals, teams, and thereby agencies tends to be difficult to assess at each stage in enforcement.

- i. It is, for example, difficult to determine whether an increase in arrests reflects greater efforts to faithfully enforce the law, inept or indifferent efforts to distinguish the guilty from the innocent, increased effort to suppress those whose opinions deviate from those governing the community of interest, or increased efforts to "shakedown" persons, many of whom are willing pay bribes to avoid prosecution or to have their penalties reduced.
  - ii. The same tends to be true with respect to convictions in court and the stringency of punishments.
  - iii. Indeed, corrupt law enforcement can create new social dilemmas that, when left unresolved, reduce rather than increase the attractiveness of communities and the extent of commerce.
- C. Consider for example, the effect of law enforcement on pragmatic sellers who are inclined to make fraudulent offers to their customers (Table 10.1).
- i. If the anticipated fine,  $F$ , is sufficient, pragmatic sellers will resist that temptation and make only honest offers. This is the traditional law and economics solution to crime.
  - ii. In the absence of such enforcement, such markets tend to disappear as their potential customers anticipate only fraudulent offers for such products.

**Table 10.1 Effect of Well-Enforced Laws Against Fraud**

	Richard (buyer)	
Gary (seller)	Richard Accepts	Richard Rejects
Fraudulent Offer	3-F, -3	1-F, 0
Honest Offer	2, 2	-1, 0

No Offer	0, -1	0, 0

Making and accepting offers are assumed to cost the person making or accepting the offer 1 dollar or unit of the net benefits or utilities used for payoffs. Notice that there may be one or two Nash equilibria in this trading game. (Gains from trade are not automatically realized.) The fraud in question is one that cannot be easily recognized at the point of sale.

D. Law enforcement can thus potentially improve and extend markets.

E. Now assume that the persons enforcing the law are not themselves bound by ethics or other anticorruption laws and have the discretion to arrest the fraudulent seller or not, or to impose a fine on the fraudulent seller or not.

- i. Such discretion nearly always exists because judgement is always part of the law enforcement process.
- ii. Knowing this, a pragmatic seller might offer to pay (bribe) the persons charged with enforcing the law to ignore his or her crime.
- iii. A single seller who is able to avoid the antifraud law can profit by making fraudulent offers to unsuspecting sellers—who may believe that antifraud law is well enforced and thus reasonably conclude that only honest offers are made.

- iv. In such cases, a pragmatic seller can offer an amount up to the profits associated with fraudulent sales to the person(s) tasked with law enforcement (here, up to  $3-2=1$ ).
  - v. The amount actually required depends on the law enforcer and the risks that he or she faces with respect to accepting bribes.
  - vi. If there is no risk and no guilt associated with accepting bribes, even a small bribe may suffice to blunt the effects of the antifraud law on pragmatic sellers.
  - vii. If this is true of all law enforcers, all pragmatic sellers will pay small bribes, the antifraud laws will go unenforced, and commerce will fall to zero or near zero in markets populated only with pragmatic sellers where fraud is profitable.
- F. The mere creation of antifraud laws with significant fines and an organization tasked with enforcing the law is not sufficient to solve the problem of fraud. The laws must be faithfully enforced.
- G. One possible method for reducing bribery is the adoption of anticorruption laws. However, these too must be faithfully enforced to resist the propensities of pragmatists to accept and share their bribes with those charged with enforcing antibribery laws.
- H. Table 10.2 illustrates this possibility for the case in which each law enforcer is paid salary  $S$ .
- i. The person (Andrei) charged with enforcing the antifraud law can receive a bribe of amount  $B$ , but would have to pay a fine of amount  $F$  if he does so and the antibribery law is enforced.
  - ii. Such laws will tend to bind if  $F > B$ . However, the enforcer of the anticorruption laws (Toke) may also be a pragmatist.
  - iii. By sharing the bribe, both pragmatic enforcers are enriched by the bribe, and neither law is enforced.

Table 10.2 The Enforcement Dilemma:

		Toke, Enforcer of anticorruption laws	
Andrei		Enforce Law	Accept Bribe
Enforcer of anti-fraud laws	Enforce Law	S, S	S, S
	Accept Bribe	S+B-F,S	S+B/2, S+B/2

Note that the bribe sharing arrangement is the Nash Equilibrium.

- I. A single equilibrium emerges in this game, one that is mutually beneficial for both law enforcers.
  - i. Note that there is no incentive for either law enforcer to propose or develop alternative institutions, in contrast to incentives associated with many social dilemmas.
  - ii. The dilemma is external to the enforcement agencies.
  - iii. The losers from such dereliction of duties are not the law enforcers or their agencies, but those who benefit from law enforcement—here honest sellers and consumers.
  - iv. Notice that this enforcement dilemma cannot be addressed by adding another level of law and law enforcement. The same logic would apply to higher levels of law enforcement when staffed by pragmatists.
  - v. Pragmatists only enforce the laws when doing so increases their effective salaries or otherwise advances their interests, which fully enforcing the

laws does not do, whenever bribery and similar types of trades are profitable and not easy to detect.

**J. Ethical Dispositions and the Effectiveness of Law Enforcement**

- i. Solutions to the problem of bribery are difficult to imagine if law enforcement is always undertaken by pragmatists.
- ii. The distribution of bribe revenues within enforcing agencies might vary among corrupt organizations, although in general the upper levels of officialdom would attempt to extract most of the bribe revenue for themselves.
- iii. The social dilemmas that laws and law enforcement are supposed to solve remain unaddressed, because uniform enforcement is not in the interest to those employed by enforcement agencies.
- iv. One possible solution to the corruption dilemma is recruitment of honest law enforcers for the senior positions.
- v. A senior official that supports the rule of law or opposes corruption for other reasons, might attempt to hire dutiful law enforcers for positions in the anticorruption and antibribery enforcement agencies.
- vi. Such ethical law enforcers would resist taking bribes because they regard accepting bribes to be immoral and would feel guilty when doing so.
- vii. A variety of ethical theories—although not all—may lead dutiful law enforcers to such conclusions.
- viii. Such an enforcer might regard abiding by the laws to be necessary for societies to be viable, as argued by a Hobbesian. Agents that have promised to enforce the law when they accepted their jobs and took oaths of office or signed papers that include duties may do so because they have internalized a duty for keeping one's promises and oaths.

ix. Others may simply regard the law to be special and deemed worthy of support merely because it is "the law."

**Table 10.3 An Ethical Solution to the Enforcement Dilemma:**

		Toke, the Honest Enforcer of anticorruption laws	
Andrei		Enforce Law	Accept Bribe
Enforcer of anti-fraud laws	Enforce Law	S, S+V	S, S
	Accept Bribe	S+B-F, S+V	S+B/2, S+B/2

Note that if V is sufficiently strong, Toke will enforce the law and so will Andrei. ( $V > B/2$  and  $F > B$  are sufficient to solve the problem)

- x. Notice that the reserve dispositions do not work as well. In the case in which the lower-level enforcer is dutiful and the upper-level enforcer is a pragmatist, the antibribery laws may be enforced, but the upper-level enforcer will be unhappy with the antibribery enforcer's behavior.
  - a. He would rather have a bit of extra income than have the antibribery laws perfectly enforced. As a consequence, upper-level pragmatists can make life difficult for the honest antifraud enforcer.
  - b. He or she might, for example, file unflattering reports or falsely accuse such agents of corruption.
  - c. Insofar as the anticorruption bureau plays a role in hiring, pragmatists at that agency will prefer to staff the antifraud agency with fellow pragmatists to profit from their "flexibility."
- xi. Of course, it would be better still to have ethical enforcers at both agencies, because bribery is difficult to monitor and anticorruption laws

are therefore difficult to perfectly enforce by even the most virtuous and hardworking anticorruption agencies.

xii. Laws have no effects on pragmatists unless they are enforced.

**V. Ethics and the Severity of Agency Problems in Governance**

- A. The problems of law enforcement is not the only agency problem faced by governments or government agencies. All large organizations confront a variety of agency problems that have to be overcome if they are to advance organizational aims effectively, whether the aim is profits, votes, public service, or the welfare of the organization's most powerful officials.
  - i. The bribery problem discussed in the previous section is one of many such problems.
  - ii. Shirking in all of its manifestations can be a problem at every level of every large organization.
- B. Nonetheless, agency problems are arguably more severe for governments than for other organizations for two reasons.
  - i. First, the productivity of government employees and agencies is often more difficult to assess than employees in private organizations.
  - ii. There is rarely an obvious index that can be used to assess the productivity of government employees or agencies in the manner that money profits can be used for economic organizations.
  - iii. Private sector monitoring and measurement problems thus tend to be somewhat smaller, more objective, and so more manageable.
- C. Second, the agency problems of governments tend to have greater effects on persons who are not employees of government.



- i. The policy decisions of commercial organizations tend to affect only their employees, suppliers, and customers.
  - ii. The effects of malfeasance by senior government officials tend to negatively affect people throughout a given society.
- D. Abuse of authority problems do not always affect the magnitude of an organization's output, but may also affect the nature of the output produced, how it is produced, and how it is used. In private firms, a firm's "buyers" may purchase inputs from friends and family members or receive "kickbacks" from suppliers, rather than purchase them from the least-cost or highest quality sources.
- i. Such abuses tend to increase production costs and somewhat reduce a firm's profits, although it may not affect total profits.
  - ii. Similar abuses of authority in governments often involve larger contracts and so have larger effects on the distribution of profits among firms and income levels of government officials (through bribes and kickbacks). Subsidies may be targeted at particular persons or industries; some areas of tax law may be better enforced than others.
  - iii. Of course, the latter may advance general interest insofar as some areas or law are deemed more important than others, but corruption can cause the allocation of enforcement efforts to advance narrow rather than general interests.

## VI. Ethics and Expressive Voting

- A. Brennan and Hamlin (1998) introduced the idea of expressive voting to the public choice literature, pointing out that what they call "expressive interests" can be advanced simply by casting a vote whereas influence over public policies occurs only with the probability that one's vote will influence the outcome--which is highly improbable.
- i. They argue that when voters have expressive interests, they will tend to vote "expressively" rather than pragmatically. And, that as a consequence

it is possible that when they actually are decisive, they get policies that the actually oppose (overall) rather than favor.

- ii. However, this result only occurs when a voter's practical or pragmatic interests differ significantly from his or her "expressive" interests.
  - iii. (Caplan (2011) uses their idea as the foundation for a critique of rational voter theories.)
  - iv. Precursors of the Brennan and Hamlin paper include Tullock (1971, *Ec Inq*), Fiorina (1976), and Glazer (1992).
- B. Insofar as a voter's expressive interests are generated by moral or cultural interests, this implies that voting tends to be more moral and more culturally motivated than decisions in their lives as private citizens.
- i. This follows because in one's day-to-day decisions one can achieve the outcome that he or she wants more or less deterministically rather than with a very low probability of success. They thus account for both in their day to day decisions.
  - ii. However, in casting votes, they will tend to "over weight" their moral or cultural expressive interests because only those can be obtained with a high probability. When one votes expressively, a voter instantly gets his or her expressive benefits, whereas getting his or her practical benefits through voting is far less likely.
  - iii. All this suggests that "identity" and "religion" based voting will be more common than "instrumental" or practical voting of the sort relied on in most election based models of public policy.
  - iv. Whether this is true or not is subject to empirical tests--some of which find support for the expressive voting hypothesis. See for example Tyran (2004, *J Pub Econ*), Sobel and Wagner (2004, *PC*), Hamlin and Jennings (2011, *BJPS*).