Generality and the Efficiency of Government Decision Making

Roger D. Congleton
Center for Study of Public Choice
George Mason University
6-13-02

I. Introduction

Most democratic governments have explicit requirements that a nation's civil and criminal law applies equally to all those who live within its boundaries. For example, the 6th and 14th amendments of the U. S. constitution assure due process and equal protection under federal law. Similar protection is assured under Article 3 of the German Basic Law, Article 1 of the French constitution, Article 14 of the Spanish constitution, and Article 14 of the Japanese constitution. Buchanan and Congleton (1998) argue that the generality principle can, and should, be applied to other areas of public law and public policy as well. For example, one can apply "equal treatment under the law" to taxation and expenditure policies, which is rarely done. Just as the principle of equal protection under the law limits opportunities for the criminal justice system to be used to punish members of a minority, so would its application to taxation and government services limit opportunities for fiscal exploitation of minorities.

The generality principle in the context of a political constitution is the requirement that all persons within the polity be treated equally by their government. Its application can be defended on numerous grounds. For example, generality is clearly supported by democratic norms that regard all persons to be fundamentally equal as citizens--one man, one vote, by norms of procedural fairness that require all persons to play by the same rules, and by norms explicitly concerned with equality as with "equal opportunity" and "equity" norms. However, the case for adopting a constitutional generality principle can also be grounded in economic and political efficiency. That is to say, the citizens of a polity who do not broadly support democratic or egalitarian norms may nonetheless have a constitutional interest in the generality principle because it tends to increase the efficiency of democratic decision making and the policies adopted (Congleton, 1997; Buchanan and Congleton, 1998).

II. Political Efficiency and Distributional Aspects of the Funding of Pure Public Goods

The logic of the efficiency argument can be demonstrated with the classic welfare economics case for government intervention, the provision of pure public goods. A pure public good exhibits non-rivalry in consumption and is produced in a manner that precludes exclusion. Private (market) production of pure public goods tends to be suboptimal, because self-interested individuals take account of their own benefits and costs when producing or purchasing such goods and services, but neglect those realized by others. From the vantage point of a single individual, "all goods are private." In the usual characterization of equilibrium, relatively low demanders free ride on the efforts of relatively high demanders. Although low demanders are willing to contribute at the margin to secure greater service levels, transactions costs are assumed to preclude these demands from being satisfied through ordinary private markets.

Collective (government) provision can, in principle, use coercion (taxation) to fund a level of the public good or service that satisfies the Samuelsonian (1954) characterization of Pareto-efficient production, and the taxes imposed can, in principle, be apportioned so that everyone in the polity secures positive net benefits from the services produced (Wicksell, 1967, and Lindalh, 1967). It is clear that government provision of a pure public good tends to be consistent with the generality principle insofar as everyone, more or less by definition, obtains the services.

However, financing the collective provision of a pure public good necessarily requires the shift of *private* (excludable) resources from the private sector to the public sector. Consequently, public finance will not automatically satisfy generality, nor the tax norms of Wicksell or Lindalh, even if the service and level funded do. Consider the following two-by-two matrix characterizing the net of tax benefits from a nonexcludable government service received by members of two groups in a polity of interest.

Table I

		B's Obligation	
		B contributes to the service	B does not contribute to the service
A's Obligation	A contributes toward the service	I 2, 2	II -2, 3
	A does not contribute to the service	III 3, -2	IV 0, 0

The assumed net benefits imply that the typical member of group B prefers fiscal package represented by the upper right hand cell (II) and that the typical member of group A prefers that represented by the lower left hand cell (III). Imposing the full cost of government services on the other group clearly improves the welfare of the group freed from taxes.

Suppose that majorities in the decision body of interest are slender, and consequently, the majority is alternately dominated by members of group A and group B. In this political environment, members of A and B each secure special privileges in the short run, but are bound to lose them in the long run, because all electoral winners eventually become electoral losers. In the case of an equally rotating majoritarian cycle, the members of group B and group A each determine the distribution of tax burdens approximately half of the legislative sessions. Each group benefits from democratic rule in spite of its instability, because government provision of this service is assumed to generate sizable aggregate net benefits. The average net benefit for typical members of both groups within an evenly rotating majoritarian cycle is $0.50 = 0.5(3) + 0.5(-2)$.

However, members of each group would be better off if they adopted a generality rule that restricts tax policies to ones that treat everyone equally. Note that if majoritarian decision making is constrained by a generality rule, both groups A and B will favor production with uniform taxation over non-production, 2>0. The members of each group realize higher net benefits under a generality rule than under unconstrained majority rule, 2 > 0.5 . In such political settings, a generality constraint clearly increases the efficiency of majoritarian decision making.

In addition to stabilizing majoritarian politics, a generality constraint also reduces rent-seeking activities, because it reduces opportunities for preferential

treatment. For example, government services such as highways, higher education, parks, medical care, and legal advice principally benefit those who use them, and are also substantially excludable. In the absence of a generality rule, relatively small groups might lobby for a new local bridge, park, or highway to be built using general tax revenues. The generality principle requires that each level of government provides its services uniformly to all within its jurisdiction or not provide them at all. This clearly reduces incentives to invest resources to secure targeted services funded by general revenues, because narrowly targeted programs and taxes are ruled out of bounds. A generality constraint reduces the scope for both majoritarian cycles and distributional conflict.

It might be argued that uniform service levels are impossible. After all, any service that is uniformly provided in some sense will be unequal in another as long as people and circumstances differ. For example, uniform service levels imply different subjective benefit levels unless all users are homogeneous. However, to the extent that benefits have measurable correlates, such as monetary net advantage or objective service levels, more generality is clearly distinguishable from less generality in a broad range of cases. The political efficiency associated with the generality principle arises because of the *predictable effects* of uniform provision of tangible services and taxes on subjective incentives for political action.

III. Generality and the production of government services

Unfortunately, even if all government services are uniformly available to all taxpayers and funded by uniform proportional or lump-sum taxes, distributive conflict often remains, because government services can be produced in a variety of ways, by a variety of firms, and in a variety of locations. These distributional aspects of the production of public services are often neglected in public choice research, and can be safely neglected in cases where the government is simply another consumer in a larger competitive market, as when it purchases coffee, paper goods, or personal computers for small numbers of office workers. Both local governments and small national governments often purchase goods in extensive national or world markets. In such cases, decisions that affect how and where a government purchases inputs will be relatively uncontroversial inasmuch as no profits or rents are generated by those decisions. However, in cases where government production decisions have significant effects upon the distribution of profits or rents within particular markets, this neglect is unlikely to be benign.

Beside generating political cycles, which may also cause economic cycles as government purchases are targeted and retargeted to regions favored by successive legislative majorities, the wealth effects of alternative methods of production create incentives for firms and individuals to invest significant resources in lobbying government decision makers for contracts and for high service levels. Other firms and individuals that stand to lose from higher input prices will oppose local production and favor lower service levels. To the extent that pro-service lobbies are more effective than their counterparts, service levels will exceed those which would have been sufficient to satisfy consumer demands for government services (at given tax prices).

A. Generality and relative price neutrality in the production of government services

In either case, the pecuniary interest of suppliers in securing increased demands for their services may play a significant role in determining the location and manner in which government services are produced, their output levels, and, thereby, the mix of services produced. Even in cases where government purchases take place in large well-developed competitive markets, purchases are often on such a scale as to affect relative prices and thereby the profits and wages of those producing the services provided. It is clear, for example, that a good deal of United States agricultural policy in the past half century has been predicated on such relative price effects. Similar effects are evident in cases where government services are produced by industries that are concentrated in particular regions of the polity of interest.

Generality requires that production decisions, themselves, not confer benefits or costs on specific individuals, industries, or regions of the country. That is to say, the production of government services should not itself materially alter the distribution of wealth or income.

Complete generality requires the *absence of significant relative price effects* in the production of government services and in the funding and distribution of those services. Relative price neutrality implies that no firms or factors of production stand to profit or lose from decisions regarding the allocation of production among firms or regions. In this case, neither firms nor factor owners would have a pecuniary interest in the level of government services provided. Even in cases where a program is explicitly redistributional, as might be said of welfare of social security, generality

requires that the relative prices of factors used to produce those services not be materially affected.

However, aggregate price neutrality is not sufficient to reduce cycling and rent-seeking problems. Program A may drive up the demand for labor whereas program B drives up the demand for capital. In this case, labor clearly would lobby for increases in Program A, whereas capital owners would lobby for increases in Program B. Majoritarian cycles among coalitions of such groups would generate significant changes in the composition of government output and in the distribution of wealth. Aggregate relative price neutrality ameliorates these problems only in the case where the apportionment of government revenues to particular services is taken as given. In this last case, supplier incentives to lobby for (proportional) increases in the output of government services would be absent. In other cases, neutrality in the large does not necessarily improve the efficiency of majoritarian decision making. Relative price neutrality and generality are identical only if neutrality holds at the *service by service* level of analysis.

B. The generality-efficiency tradeoff in the production of government services

In a broad range of cases, there is no trade off between generality and ordinary economic efficiency in the production of government services. In such cases, distributing the production of government services more uniformly throughout a government's jurisdiction reduces relative price effects and increases the political efficiency with which services are selected without increasing the cost of government services.

On the other hand, there clearly are cases where locational economies are substantial and/or where markets for specialized inputs are too small to support more than a handful of efficiently sized producers. This might be said, for example, of the manufacture and servicing of submarines. In cases where economies of scale are significant, one can imagine settings where all voters prefer low-cost concentrated production to more costly decentralized production. Those same voters may, nonetheless, disagree about the "most advantageous" location of production insofar as specific communities gain (or lose) from securing the production site. In such cases, production should not be deliberately decentralized, but the institutions of fiscal choice should be constructed in a way that preserves the generality norm. For example, random or lottery-like selection among specific options can be used to

assure *ex ante* generality at the time long-term production commitments are being contemplated. Production authority might also be delegated to a commission of "experts" whose opinions are not well known beforehand. Generality at the level of monetary net benefits may also be increased by "packaging" many production decisions into one legislative action

IV. Conclusion and Summary

The manner in which public services should be distributed and financed has long been issues at the core of welfare economics. The main stream literature that has emerged addresses a variety of questions about the optimal level of provision and methods by which such goods should be financed. Less attention has been focused on the process by which public services decisions are actually made, and on the manner by which those procedures could be improved. However, clearly, the demand and supply of government services should be analyzed in conjunction with the political institutions under which fiscal policy choices will be made.

When fiscal policies are adopted via majority rule, application of the generality principle to the production, distribution, and financing of government services reduces the range of distributional conflict that occurs and thereby increases political efficiency in several ways. Other rules for apportioning services might serve this end as well, but those distributional rules would not be as broadly acceptable as the ones implied by the generality principle, because non-general rules would only infrequently increase each person's welfare over the unconstrained case. In this sense there may not be a trade off between equity and efficiency at the constitutional level of politics.

We do observe that many public services are distributed, financed, and produced in rough accordance with the generality principle in modern democracies, as with social security programs, law enforcement, and public education. However, causal observation also suggests that political efficiency within most democratic politics could be further improved by greater deference to the generality principle. Many deviations from generality remain significant. The tax code continues to treat different kinds of income differently, and many public services are produced and distributed in a less than uniform fashion. In many cases, the manner in which public capital projects are produced and distributed seems to reflect the effective political power of regional representative more than the generality principle. Indeed, the existence of all narrow industrial, labor, and regional lobbying groups implies that the

level of generality practiced is imperfect, and that political efficiency could be improved by greater adherence to the generality principle.

Selected References

Buchanan, J. M. (1949) "The Pure Theory of Public Finance," *Journal of Political Economy* 57: 496-505.

Buchanan, J. M. (1968) *The Demand and Supply of Public Goods.* Chicago: Rand McNally.

Buchanan, J. M. (1976) "Taxation in Fiscal Exchange," *Journal of Public Economics* 6:17-29.

Buchanan, J. M. and Congleton, R. D. (1998) *Politics by Principle, Not Interest: Towards Nondiscriminatory Democracy.* Cambridge: Cambridge University Press.

Congleton, R. D. (1997) "Political Efficiency and Equal Protection of the Law," *Kyklos* 50 (1997): 485-505.

Congleton, R. D. (1980) "Competitive Process, Competitive Waste, and Institutions," in *The Economic Analysis of Rent Seeking.* Edited by R. Tollison, and R. Congleton, Brookfield Vermont: Edgar Elgar Publishing Company: 101-30.

Hayek, F. A. (1960) *The Constitution of Liberty.* Chicago: University of Chicago Press.

Lindahl, E. (1967) "Just Taxation -- A Positive Solution," in R. A. Musgrave and A. T. Peacock, Eds. *Classics in the Theory of Public Finance.* New York: St. Martin's Press: 168-76.

Samuelson, P. A. (1954) "The Pure Theory of Public Expenditures," *Review of Economic and Statistics* 36: 387-389.

Weingast B., Shepsle, K., and Johnson, C. (1981) "The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics," *Journal of Political Economy* 89: 642-664.

Wicksell, K. (1967) "A New Principle of Just Taxation," in R. A. Musgrave and A. T. Peacock, Eds. *Classics in the Theory of Public Finance.* New York: St. Martin's Press: 72-118.