The Frank E. Seidman Distinguished Award In Political Economy

Acceptance Paper By

GARY S. BECKER

Special Interests and Public Policies

Award Bestowed September 26, 1985

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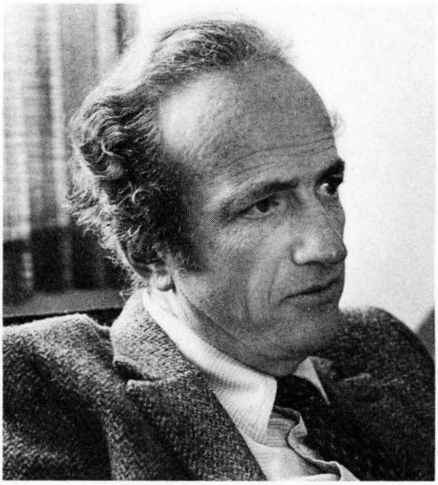

GARY S. BECKER

RECIPIENT of TWELFTH ANNUAL FRANK E. SEIDMAN DISTINGUISHED AWARD in POLITICAL ECONOMY

Memphis, Tennessee, September 26, 1985

Dr. Gary S. Becker, internationally recognized for his interdisciplinary work in the fields of economics and sociology, is recipient of the 12th annual Frank E. Seidman Award in Political Economy and its $10,000 prize from Rhodes College, formerly Southwestern At Memphis.

Dr. Becker, chairman of the department of economics at the University of Chicago where he also teaches sociology, is noted for his pioneering use of economic and statistical analyses in his approach to socio-economic studies.

Through his interdisciplinary work, Becker opened the field of economics, applying it in places previously unexplored. His 1964 book "Human Capital", for which he won the first W. S. Woytinsky Award from the University of Michigan, transformed the field of labor economics. He has been called "the practical progenitor of that branch of economics known as human capital, meaning the analysis of investment in the education and skills of a nation's population."

In "The Economics of Discrimination" Dr. Becker analyzes the cause and effect of discrimination in employment and earnings, and in other works he explores the economics of crime and punishment, the allocation of time, fertility, even suicide.

Dr. Becker is a member of several professional societies. This year he was elected president of the American Economic Association which in 1967 awarded him the prestigious John Bates Clark Medal. He belongs to the American Statistical Association, the Econometric Society, and was elected to the National Academy of Sciences, American Academy of Arts and Sciences and National Academy of Education.

A summa cum laude graduate of Princeton University where he was elected to Phi Beta Kappa during his junior year, Dr. Becker holds a master's degree and Ph.D. from the University of Chicago.

He has taught at Chicago since 1970 and was a Ford Foundation Visiting Professor of Economics there in 1969-70. Dr. Becker also has taught at Columbia University where he was Arthur Lehman Professor of Economics.

SPECIAL INTERESTS AND PUBLIC POLICIES

by

Gary S. Becker

I. Selfishness in the Marketplace

Let me start with a quotation familiar to some of you: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." The same author went on to say with some irony, "We are not ready to suspect any person of being defective in selfishness." These are statements by Adam Smith, the founder of modern economics. The first statement is from the greatest book ever written on economics, called The Wealth of Nations, the second from a good, but less impressive, book called The Theory of Moral Sentiments.

Smith was not stating that he thought people *should* be selfish, as argued in certain modern philosophies, but was assessing how people typically *are* motivated. However, he did develop a different type of normative analysis. In a remarkable argument he showed that under appropriate conditions, it does not matter that people are selfish. For a selfish person, and I quote the most famous statement in The Wealth of Nations, "intends only his own gain and he is in this as in many other cases led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it." How can such an optimistic statement at the very beginning of the science be reconciled with the claim that economics is "the dismal science"?

In an important sense, Smith can be said to have shown how societies can economize on love, that very scarce "resource." Smith was not happy that people are selfish; he wished that people were more altruistic. But he was hard-headed and a scientist, and accepted people the way they are. Since people are generally selfish, societies cannot be organized around love. Fortunately, however, he was able to show that selfish people, under appropriate conditions, are led by this invisible hand to promote the public interest. In other words, it is not necessary to have much altruism when selfish persons can be induced to act *as if* they are altruistic toward others.

His argument should be familiar since it has been elaborated by the economics profession during the last two hundred years. If some firms are not promoting the public interest — if they are making excessive profits — he argued that other firms would start competing against them (if permitted to compete), and this would lower market prices until they equalled costs. Similarly, if firms could sell at a higher price in one geographical area than in another area, they would ship goods to the area where they could sell at the higher price, lowering the price there and raising the price in the first area. Moreover, workers free to change jobs would leave low paying jobs or those with poor working conditions and compete for the better jobs. Their competition equalizes wages and conditions in different jobs. And so on for other market adjustments.

Smith rightly emphasized that the "invisible hand" requires competition between firms, consumers, and workers: the freedom to enter and exit from industries, jobs, and consumer products. It also assumes that government intervention does not prevent competitive prices from emerging. Smith's analysis of competition has been maintained unchanged in modern economics except for the development of a more sophisticated and complete analysis of the conditions when self-interest promotes the general welfare.

One prominent condition is the absence of direct interactions between people or between firms and people. They interact, for example, when firms spew smoke into surrounding neighborhoods, as steel mills in Gary, Indiana pollute the area of Chicago where I live (although the air has becomme cleaner as the domestic steel industry encountered bad times). Firms usually do not take account of the harmful effects they impose on others unless forced to do so. Another condition is that transactions must be feasible. The cost of transacting cannot be large enough to prevent mutually profitable and mutually beneficial transactions. Smith's conclusion does not follow when there are direct interactions or large transaction costs, and selfish behavior may not promote the general welfare.

II. Selfishness in the Political Sector

It is natural to look to governments to offset the harmful effects of selfish behavior. Adam Smith himself advocated a significant government role. These included protection against foreign aggression and domestic crime, the enforcement of contracts, and the provision of education.

During the first half of the twentieth century, economists usually assumed that governments are benevolent. Governments were believed to act to control the effects of direct interactions and transactions costs, and to tax income and wealth to achieve an ethically sound distribution of resources. Our founding fathers, however, had a more skeptical and realistic view of government. They knew that governments can be oppressive, and that governments often cater to powerful special interests. The founding fathers tried to design a constitution and other procedures that would limit oppression and the power of special interests, and yet would permit governments to carry out tasks that could not be handled well privately.

Economists have also begun during the past thirty years to take a more realistic view of government behavior. The considerable analytic artillery of modern economics is being used to develop an understanding of how governments actually behave. I would like to sketch out some of the conclusions and insights that have been obtained.

Governments do not automatically solve the problems created by selfish behavior in the marketplace primarily because bureaucrats, legislators, and voters also tend to be selfish, and seek to promote their own interests. After all, participants in the political sector are the same kind of people as participants in the private sector. Although the power and force at the disposal of modern governments can be channeled toward useful purposes, they can also be channeled toward the enrichment of powerful groups at the expense of weak groups that sometimes include a large majority of the population. As a result, government actions frequently worsen rather than improve the outcomes of private markets.

To take a common example, agricultural interests in the United States and other Western countries have used their political power to lower the production and raise the prices of sugar, tobacco, grains, milk, and other products through acreage restrictions, limits on imports, payments that require land to remain uncultivated, and in many other ways. Moreover, government assistance to agriculture has become more extensive during the past forty years as farming has shrunk to a small part of the modern economy.

Therefore, to understand what governments actually do, as opposed to what they ought to do, it is necessary to understand how selfish groups with special interests influence political outcomes. I will discuss a few implications of an analysis of political pressure groups that I develop elsewhere in more detail (see Becker [1981 and 1986]).

III. Competition Among Pressure Groups

Successful pressure groups are often small. Although sometimes there is the tyranny of the majority feared by opponents of democracy, more frequently well-disciplined small groups wield political power. Small groups are successful politically when they are well organized, and can persuade many voters and legislators to support them.

Although fewer than 11,000 farms produce sugar in the United States, they have raised the demand for domestic sugar by inducing the Federal government to restrict imports from countries (many in the Caribbean) with more efficient producers of sugar. The domestic price of sugar is now about four times the world price (20¢ per pound compared to less than 5¢ per pound). Similarly, the automobile industry in the United States only has four producers and less than 800,000 workers, yet the Chrysler Corporation managed to obtain a sizable subsidy when on the verge of bankruptcy, and the industry has been successful in getting tariffs and quotas placed on cars produced by more efficient Japanese firms.

The methods that small groups use to obtain the support of others are varied, but frequently include propaganda and highly misleading claims. Voters are vulnerable to persuasion because they do not have much incentive to become well informed about political issues since each voter has only a minor effect on political outcomes that are decided by the majority or by similar rules. Therefore, the average person knows far more about supermarket prices and the performance of cars than about import quotas and public wages. Although rational political behavior has appeared to be contradicted by widespread voter ignorance and apathy, the opposite conclusion is warranted because rational voters do not want to invest much in political information.

The ignorance of voters explains the importance of political form—including political rhetoric, the attachment to ideologies, endurance during long campaigns, and an "honest" face — because voters with little direct knowledge about matters of substance must rely on crude proxies. Doctors, the military complex, and other groups who contribute to defense, nationalism, conservation, health, and other popular goods often can elicit political support because it is easier to promote interests that are generally believed to contribute to popular goals. Moreover, research findings that oppose the interests of powerful pressure groups frequently have little political impact because they are offset by the dissemination of misinformation and by other appeals to public opinion and legislatures.

To be effective, political pressure groups must be able to obtain sufficient financial and other support from their members. Many groups cannot obtain this support because their members "free-ride;" each member provides little support in the expectation that other members will bear a larger burden. Free-riding is easier to control in groups with a few large firms or unions, or in groups that can obtain subsidies which mainly help members who contribute support.

Consider the automobile and steel industries. Each has a large union that controls the free-riding of workers through compulsory dues and other methods, and a few firms that are too large and well known to shift the burden of support for political activities to other firms. In each industry the union and the few firms have worked together successfully to pressure governments into large subsidies, notably through loans and curbs on imports.

Special interest groups are often successful politically even when their subsidies are financed by sizable taxes on other groups. However, those paying taxes are sometimes stimulated to organize and to lobby for lower taxes, and hence for lower public support to the groups who are subsidized by their taxes. This inducement to organize is a form of "countervailing power" that limits the power of pressure groups.

The potential for countervailing power implies that groups are more likely to be successful politically when the taxes on others are not large relative to their subsidies. Then even if the groups harmed did organize, they might spend less to promote lower taxes than the groups benefited would spend to promote higher subsidies. This is why crackpot proposals that greatly reduce aggregate wealth do not usually muster enough support: the political opposition is simply too powerful.

Frequently, the opposition to a subsidy grows over time because the social cost of the subsidy (the loss in aggregate wealth) grows over time. The social cost of regulated securities transactions rose significantly in the sixties and seventies as large institutional investors became important because large investors are more sensitive to the cost of transactions (see Jarrell [1984]); the social cost of regulated airline travel also rose over time as airline travel expanded into new and diverse markets (see Spiller [1983]); the social cost of regulated banking grew as interest rates became higher and more variable, and new methods of intermediation were invented (see Carron [1983]); or the social cost of high marginal income tax rates grew as tax shelters, the underground economy, and other loopholes expanded. Therefore, the recent deregulation of airlines, banks, and securities firms, and the pressure to lower income tax rates, as in flat tax proposals, supports the implication of our analysis that political opposition to a subsidy becomes more effective when the social loss from the subsidy becomes larger.

Many people have proposed that the United States and other capitalist countries adopt an industrial policy. Although industrial policy advocates in this country have quieted as our economy expanded rapidly during the past few years, they will be heard from again if the economy slips into a serious recession with a weakened manufacturing sector. However, the experience of the United States and other countries suggests that workers, management, and other interest groups will manipulate an industrial policy to promote their own special interests.

Contrary to the hopes of advocates, an industrial policy delays rather than hastens an economy's adjustment to adversity and changing conditions. The policy becomes a servant of special interests harmed by the changes rather than a promoter of the general interest. Strong confirmation of this assertion is found in the efforts since the early 1970's in the United States to develop an energy policy with tax abatements, price controls, fuel efficiency standards, excess profit taxes, and many other unwise regulations (see Daly [1983]).

The power of special interests is clearly seen also in the evolution of President Reagan's proposal for tax reform. The original proposal by the Treasury Department had many attractive features, partly because it paid relatively little attention to the political power of special interests. However, before he brought the tax reform proposal to Congress, the President made several important concessions to powerful interests. These included changes in the Treasury's proposal with regard to the deductability of: depreciation, interest payments on second homes, and expenditures on education and other nonprofit organizations. Congress is also sensitive to various interests, and will greatly change the President's proposal. Among other things, Congress is considering whether to raise the proposed maximum tax rates on personal and corporate incomes, and whether to continue the deductability of state and local taxes.

An analysis of the power of special interests implies that the Treasury's proposal would be significantly modified by the President and the Congress. The many special benefits in the tax law are not there by accident, but developed over time in response to the political power of different groups. Is there any reason to expect that their power can be simply eliminated overnight when it has been built up and cultivated for many years? Even if many groups suddenly realized that they all can be made better off when they all give up their privileges, each group has an incentive to lobby to retain its own privileges while supporting efforts to end the privileges of others.

IV. Concluding Remarks

Despite the considerable harm caused by special interests, one can go too far in condemning their activities. Actual political systems do not have benevolent dictators, or other political procedures that *automatically* choose the best level and mix of defense expenditures, useful restrictions on pollution, provisions for the education of children from poor families and other public policies that raise output and efficiency. Competition among special interest groups also contributes to the implementation of desirable policies because favorably affected groups gain more from policies that raise aggregate wealth than other groups lose. Therefore, groups benefited would spend more resources to lobby for these policies than groups harmed would spend to lobby against them.

The activities of special interest groups are more likely on balance to produce unwise government policies when there is highly unequal access to political influence. For then powerful groups can promote policies that benefit them but reduce wealth, and can thwart many policies that harm them but would raise wealth. An ideal democracy would have competition among groups with rather equal political strengths, whereas totalitarian and other nondemocratic systems have only limited competition among groups with highly unequal strength.

Adam Smith had the great insight that selfishness in private transactions works surprisingly well much of the time to promote social welfare. When it does not work well, government intervention could improve matters. But since political decisions are also dominated by selfish individuals, actual governments do not automatically improve rather than worsen the outcome of private transactions. The major difficulty in actual political decisions is that pressure groups use the power of the State to promote their own interests. A desirable political system tries to minimize the harm and maximize the benefits from the political competition among interest groups.

The founding fathers of the United States were well aware of the political power of special interests:

> A landed interest, a manufacturing interest, a mercantile interest, a monied interest, with many lesser interests, grow up of necessity in civilized nations, and divide them into different classes. . . . The regulation of these various and interfering interests forms the principal task of modern legislation, and involves the spirit of party and faction in the necessary and ordinary operations of the government. (Hamilton, Jay, and Madison [1941, p. 56])

The Constitution they produced is imperfect and has evolved greatly over time. Yet their efforts were remarkably successful largely because the Constitution takes a realistic view of how democratic governments function when exposed to pressure from competing interests.

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