THE RELEVANCE OF WELFARE ECONOMICS TO DEMOCRATIC GOVERNANCE

GREED, CHAOS & GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW. By Jerry L. Mashaw.* New Haven, Connecticut: Yale University Press, 1997. Pp. 231.

*Reviewed by Linda Y. Yueh***

> *Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist . . . . It is ideas, not vested interests, which are dangerous for good or evil.*
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> — *John Maynard Keynes*[1]

Public choice theory's relevance to democratic governance and public law is far from settled. In his book, *Greed, Chaos & Governance: Using Public Choice to Improve Public Law*, Professor Jerry L. Mashaw conducts a rare, comprehensive, and insightful review of the current state of the literature and offers some normative postulates on the future of public choice theory and its application to democratic government.

Professor Mashaw engages public choice theory on its own terms and explores how it can help "better design our public institutions."[2] In analyzing the strengths and weaknesses of public choice theory, Professor Mashaw focuses his attention on two key areas of the lawmaking process: the relationship between majority rule and judicial review, and the political and legal accountability of administrative agencies. Although he concludes that public choice does indeed have something to contribute to understanding the lawmaking process, Pro-

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1. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 383-84 (1936).

2. Jerry L. Mashaw, GREED, CHAOS & GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW 4 (1997). The goal of improving institutional design is pervasive throughout his work, which suggests that Professor Mashaw is serious in viewing positive economics, rather than the normative premises which often guide public law creation and judicial review, as the proper course.

fessor Mashaw does not argue that public choice analyses lead to "crisp resolution of what to do to make public institutions perform better."[3] Professor Mashaw contends that public choice theorists, with their "relentless focus on institutional failures and self-interested behaviors," are undermining the public's faith in the legislative process, a pillar of democratic governance.[4] Despite these reservations, Professor Mashaw concludes that "public choice consumers, critics, and analysts are together shaping a reform agenda . . . that is both energizing and reconfiguring conventional debates about how collective decision making is, and should be conducted."[5] In such an atmosphere, those pursuing the public interest must do so within a new framework—one created by public choice theorists.[6]

This review argues that the concept of equity, as developed in the context of welfare economics, should also be considered by public choice theorists in order to better understand the relevance of public choice theory to public laws.[7] In this context, this review examines Professor Mashaw's praises and critiques of public choice scholarship as well as the possibility that his thesis is not inconsistent with (indeed, it may be enhanced by) the concept of equitable governance.

I
The Utility of Public Choice Theory

Perhaps the fundamental paradox of public choice theory that Professor Mashaw addresses, and in some ways laments, is what lies at the core of economics—rational actors pursuing private self-interest. When this basic premise is applied to the idea of public lawmaking and governance, it stands at odds with the understanding and legitimate democratic expectation that officials who make public laws are doing so in pursuit of the public interest. Professor Mashaw argues, "[t]he Constitution presumes that private activity will be constrained only to promote public purposes . . . . Citizens have a constitutional right to demand that public law be public-regarding.

3. *Id.* at 208.
4. *Id.* at 80.
5. *Id*. at 209.
6. *Id*. ("In that process, we are constrained to pursue the public interest by attempting to learn from those who seem to suggest that it could not possibly exist.").
7. *See generally* Robin W. Boadway, *The Welfare Foundations of Cost-Benefit Analysis*, 84 Econ. J. 926 (1974) (discussing the need to consider distributional effects when making policy changes); Abram Burk, *A Reformulation of Certain Aspects of Welfare Economics*, 52 Q. J. Econ. 310 (1938) (discussing how to achieve optimal economic welfare when making policy changes).

Otherwise, their private harms are constitutionally inexplicable."[8] What results, Professor Mashaw suggests, is a theory of public lawmaking crippled by a built-in sense of "pessimism" as to the purposes and incentives of those who make law.

In each chapter, Professor Mashaw applies public choice theory to a different area of public lawmaking and identifies both the usefulness of the approach and the shortcomings that result from overextension.[9] Mashaw analyzes these areas of lawmaking through the application of three different strands of economic theory: voting theory (or Condorcet's voting paradox, which is most closely associated with Arrow's Impossibility Theorem);[10] interest group theory; and some variants of game or "agency" theory. In each instance, whether he is describing judicial rationality review, administrative law, or presidential accountability, Professor Mashaw convincingly outlines the

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8. MASHAW, *supra* note 2, at 80.

9. For instance, Professor Mashaw dedicates the third chapter to the issue of rationality review, which courts have been struggling with since *Lochner v. New York*, 198 U.S. 45 (1905), the New Deal, and the demise of "substantive due process." He contends that the conflation of process and substance characterizes the current state of jurisprudence and that it may be more frank to assert that there continues to be a role for substantive judicial review of legislative rationality, rather than the two current extremes of either economic or social legislation on the one hand, and suspect classifications on the other. *See* MASHAW, *supra* note 2, at 50-80.

10. Professor Arrow, the pioneer in the field, proved that there is no logical way to aggregate individual preferences and, by extension, no way to make social policy decisions that correspond to individual rankings. *See* KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (2d ed. 1970). Professor Arrow proved that there exists no Social Welfare Function that could satisfy the conditions of universality, Pareto consistency, independence, and nondictatorship.

As an illustration, let V be a group of individuals. Suppose for some preference profile and some particular pair of alternatives x and y, all members of V prefer x to y, all individuals not in V prefer y to x, and social preference is for x over y. Then, for any preference profile and any pair of alternatives x and y, if all people in V prefer x to y, the social preference must be x over y.

A group of individuals V is *decisive* if for all alternatives x and y, whenever all in V prefer x to y, society prefers x to y. The assumption of independence asserts that if V prevails when opposed by everyone else, it must be a decisive group. If the social choice procedure is majority rule, any group of (n+1)/2 members when n is odd, or (n/2)+1 members when n is even, is decisive. Majority rule thus satisfies the assumptions, since if V prevails for a particular x and y when everyone outside of V prefers y to x, then V must be a majority group and always prevail.

There must exist a decisive group of individuals since by the Pareto consistency requirement, the set of all individuals is 1. Now let V be a decisive group of minimal size. If it consists of one person, then he is a dictator. If V is more than 1, then it leads to contradiction. If 2 or more individuals are in V, then they divide into nonempty subsets V_1 and V_2. Let V_3 represent all people who are neither in V_1 nor V_2 (V_3 may be empty). Under universality, a function must be applicable to any profile of individual preferences. Take three alternatives x, y, z, and each individual's preference over each, which is transitive and complete:

existing literature and determines that public choice theory has something to contribute to each.

However, at the conclusion of each chapter, Professor Mashaw returns to a recurring theme regarding the utility of public choice theory. At the beginning of his book, he identifies the "pessimism" that lies at the heart of public choice theory, and the danger that "these descriptions will destroy the possibility for democratic governance by destroying the public faith that is its prerequisite."[11] For example, Professor Mashaw spends a significant portion of the first chapter tracing the history of the United States and the influence ideologies of the Founding Period have had through the New Deal to the present day. He concludes that "[m]odern positive political theory provides a much bleaker picture of political life than virtually any of its influential predecessors. It suggests quite strongly that no appealing version of democracy is possible and that no possible version is very appealing."[12] While public choice theory certainly has a great deal to contribute to our understanding of lawmaking, Professor Mashaw explains that a perplexing issue remains—what is the net effect of a theory of self-interested rational actors on the ideal of lawmaking in the public interest?[13]

Most $\rightarrow$ *Least Preferred*
V_1: x y z
V_2: y z x
V_3: z x y
(Condorcet's voting paradox)

Since V by assumption is decisive, y must be socially preferred to z. Under completeness, either x is preferred to y or y is preferred to x. *See infra* note 16. If x over y holds, since x is preferred to y and y is preferred to z, then x is preferred to z must hold by transitivity. *See infra* text accompanying note 15. But, V_1 is decisive by the condition of independence, and thus contradicts V's minimality. Alternatively, if y being preferred to x holds, V_2 is decisive by the assumption of independence, leading to contradiction. Therefore, V=1 and there exists a dictator. *See generally* MASHAW, *supra* note 2, at 12-15; MACMILLAN DICTIONARY OF MODERN ECONOMICS 400-01 (David W. Pearce ed., 4th ed. 1992) [hereinafter MACMILLAN].

11. MASHAW, *supra* note 2, at 25.

12. *Id.* at 12.

13. *Id*. at 11-12 ("Much of welfare economics and public policy analysis is devoted to the question of how to regulate or structure markets to make them perform better—that is, to insure the maximum increase in public welfare. Market failure is to be expected in public policy markets also, and much institutional design work will surely consist of trying to correct these failures.").

II
Alternative Approaches

Professor Mashaw's concerns regarding the "pessimism" of public choice theory, and the legitimacy of allowing self-interested actors to create laws that must, at bottom, enhance public welfare, can be addressed in two ways. The first is to relax the neoclassical assumption of perfect rationality. If individuals do not have perfect information, and therefore cannot make decisions which calculate the contingencies of every available choice, then they may not be perfectly rational but may instead be "boundedly rational."[14] If this is the case, it may not be wise, as a practical matter, to ascribe a set of perfectly transitive[15] and complete[16] preferences to policymakers who are driven to maximize their self-interest. Rather, it is likely that policymakers are individuals with mixed motivations, some of which are based on self-interest and others on altruism. Professor Mashaw notes that the literature, as well as conventional wisdom, recognizes this premise.[17] However, the notion of boundedly rational behavior cannot provide the entire answer—these actors, whether perfectly or boundedly rational, are still creating laws which may or may not increase the public welfare.[18] Furthermore, the preferences of these actors are still not aggregated in a coherent fashion.[19] Therefore, the

14. "Bounded rationality" is most closely associated with the work of behavioral economists, notably Professor Herbert Simon. *See, e.g.,* 2 Herbert A. Simon, Behavioral Economics & Business Organization 408-23 (1982); *see also* Macmillan *supra* note 10:

> A notion, developed by H.A. Simon, which proposes that although individuals behave rationally, in that their preference ordering is complete, consistent and transitive, their ability to obtain and process information is bounded, i.e. it is limited by the computational capacity of the human mind. In consequence as tasks become more complicated individuals adopt simplifying strategies and the use of decision rules and heuristics become more common.

Id. at 43.

15. *See* Macmillan, *supra* note 10, at 24 ("The axiom of transitivity . . . states that if some combination of goods A is preferred to another combination B, and B is preferred to C then (by transitivity) A is preferred to C . . . . [V]iolation of the transitivity axiom is widely construed as an indication of irrationality.").

16. *See id*. ("The axiom of completeness . . . simply states that the consumer is able to order all available combinations of goods according to his preferences.").

17. *See* Mashaw, *supra* note 2, at 67 ("The difficulty has been to sort out the public from the private, given the wide range of efficiency and equity concerns that might actuate public policy. . . .").

18. *See generally* Theodore Groves & Martin Loeb, *Incentives and Public Inputs*, 4 J. Pub. Econ. 211 (1975); Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 Rev. Econ. & Stat. 387 (1954).

19. The inability to make interpersonal comparisons of utility and the subsequent impossibility of aggregating preferences have been explored most profoundly in the

answer cannot be as simple as challenging the assumption of rationality in public choice theory.

The second alternative, and one that may hold the greatest possibility of explaining some of the utility and limits of public choice theory, relates to the criteria which govern the definition of social welfare. The core question in both Professor Mashaw's book and public choice economics relates to whether or not the self-interested actions of political actors will, like the invisible hand in markets, create greater social welfare for government and its people.[20] One of the continuing difficulties of measuring social welfare is not only that interpersonal comparisons of utility cannot be made, but also that it is extremely difficult to determine what constitutes an increase in social welfare. In neoclassical economics, the criterion used to judge the whole of social welfare is efficiency. For example, if we build a highway in Orlando, Florida, will it be more efficient than building a local road in Newark, New Jersey? If we create a system of food stamps, is that more efficient than having the government collect food items and distribute them? Of course, as even casual observers of politics know, the decisions to build a highway or to adopt a program of food stamps are not based on simple considerations of efficiency. After the fact, however, decisions such as these are typically evaluated for their contribution to social welfare in terms of their efficiency.

III
ADDING EQUITY TO THE EQUATION

Rather than merely efficiency or pessimistic social welfare measures, both efficiency *and* equity should provide the basis for evaluations of public laws.[21] We should not be dismayed that lawmakers are self-interested actors, nor should we be concerned whether the "invisible hand" works in government as it does in markets. Instead, as a democratic society, we should be concerned whether the actions of our

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work of Professor Arrow. *See* ARROW, *supra* note 10; *see also* J. DE V. GRAAFF, THEORETICAL WELFARE ECONOMICS 35-47 (1957) (comparing various methods for defining "quantities of satisfaction" and "utility"); AMARTYA K. SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE (1970); Nicholas Kaldor, *Welfare Proposition of Economics & Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939) (arguing that even if aggregate income increases, some individuals may be worse off); T. de Scitovsky, *A Note on Welfare Propositions in Economics*, 9 REV. ECON. STUD. 77 (1941) (noting that change in welfare does not have uniform effect).

20. This question was answered in the affirmative by Professor Becker. *See* Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983). However, as Professor Mashaw notes, there is a lack of empirical testing of this point. *See* MASHAW, *supra* note 2, at 88-89.

21. I refer to the concept of equity in its distributional sense.

legislators, mixed in their motives, will be both efficient and equitable. Will these legislators (or administrators or the President) make decisions that enhance the overall social welfare by allocating resources in an efficient manner, but also in a manner that benefits the least, rather than the most, privileged members of society?[22] Ensuring that our laws are public welfare-enhancing and not solely private rent-seeking is a matter of democratic necessity.[23]

It may be granted that, once the concept of equity is layered upon the definition of social welfare, it is still the case that we cannot aggregate and cannot calculate the whole of the social welfare function. We can, however, know whether or not the social welfare pie has been redistributed from the advantaged to the disadvantaged. Moreover, seeking both efficiency and equity is consistent with Professor Mashaw's recurring theme of utilizing public choice theory as an impetus for institutional reform.[24] In a society that values equitable distribution of government resources, equity must play an essential role in public choice decision making to address the concern that rational actors merely account for personal preferences and self-interest. Consequently, public choice theory can serve as an effective and preferred model for institutional reform.

A rational actor's incorporation of equity into preferences and decision making may assuage Professor Mashaw's concerns about pessimism. The salience attributed to equity considerations by rational actors indicates that legal scholars should look to the positive impact of public choice theory on legal change and legal rule making.

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22. The issue of distribution has been addressed by a wide and impressive range of scholars, from Professor Rawls's "veil of ignorance" to Professor Coase's theory of "equitable distribution." *See generally* JOHN RAWLS, A THEORY OF JUSTICE 136-42 (1971); Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). However, it remains the case that the idea of equity remains underemphasized in discussions of economics, and much more development is needed in the field of welfare economics.

23. Professor Mashaw, in fact, argues that the "appropriate constitutional demand is not for 'rational' or 'efficient' legislation, but for legislation that is public-regarding—that can make a coherent and plausible claim to serve some public, rather than a merely private, interest." MASHAW, *supra* note 2, at 66. He suggests that the notion that "such a demand has support in the Constitution itself is relatively nonproblematic. There is hardly an idea of greater moment in the whole of the constitutional structure than the notion that public legislation should provide for the *public* welfare." *Id*.

24. For one proposed mechanism of equitable distribution, see COASE, *supra* note 22 (arguing that Coasian bargain posits that if there is a set of clearly defined property rights, then there exists a Pareto-improving outcome in which winners can, in theory, compensate losers of particular exchanges or legislative enactments). *See also* Kenneth J. Arrow, *An Extension of the Basic Theorems of Classical Welfare Economics*, *in* PROCEEDINGS OF THE SECOND BERKELEY SYMPOSIUM ON MATHEMATICAL STATISTICS AND PROBABILITY 507 (Jerzy Neyman ed., 1951).

To this end, Professor Mashaw's review of the current state of the literature is an extremely important and helpful resource for those seeking to better understand the behavior of lawmakers and for those who are concerned with the making and application of law in a democratic society.