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The Economic Study of Politics: Insights and Reflections

O Estudo Económico da Política: Observações e Reflexões

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ABSTRACT
Economic and political phenomena coexist in society, but are often seen as divergent spheres of human action and interaction. A theoretical manifestation of this separation is the assumption that while economic agents act in their own self-interest, political agents are motivated by the public interest. Additionally, it is commonly assumed – if only implicitly – that political agents possess all the necessary knowledge for rational action, effectively portraying political agents as omniscient beings. Drawing on public choice theory and on the economic literature on the nature of knowledge, we review arguments that challenge the two assumptions.
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1. Introduction

Economic and political phenomena coexist in society but are often seen and treated as divergent spheres of human action and interaction. Two crucial assumptions reify this view. On the one hand, governments are often portrayed as guardians of the public interest and thus act to achieve a social optimum. In other words, they are benevolent. The other crucial assumption is that political agents possess all the necessary knowledge for rational action, effectively portraying political decision-makers as omniscient beings. A prominent example of the use of these assumptions is the celebrated paper on optimal economic growth by Cass (1965).

Obviously, such assumptions are hardly realistic. First, political agents may indeed act in the public interest, but often that is subordinate to their own private interest. Second, as the debates on the challenges of economic planning have made clear, the necessary knowledge is not given or easily obtained due to its inherent properties. Its creation and transmission are contingent upon the existing institutional context. Assumptions of perfect knowledge are, therefore, at best approximations, if not downright misleading.

This short note collects some insights from the relevant literature to reflect on the assumptions identified above. The next section focuses on the public choice challenge to the benevolence assumptions. Section 3 discusses the knowledge problem and argues that it is present in political settings. Section 4 concludes.

2. Is Human Behaviour Bifurcated? Individual Choice in Markets and Collective Choice in Governments

Markets and governments are different in many respects. In markets, individuals are sovereign; in government, choices are made in the name of all citizens. In markets, transactions are voluntary; in government, policies are applied coercively. In economic theory, individuals, *qua* economic agents, have often been assumed to be motivated by self-interest – the *homo economicus* – namely in the neoclassical tradition descending from Jevons (1871). Conversely, politicians, or the *homo politicus*, are typically portrayed as devotees of the public interest – a form of altruism which guides their actions toward the collective good[1]. This section examines the validity of this common assumption of a bifurcation in human behaviour, wherein individuals act out of self-interest within market contexts but exhibit selflessness in political arenas.

This bifurcation assumption was explicitly challenged by James Buchannan and Gordon Tullock in The Calculus of Consent (1962), where they observed that the *homo economicus* and *homo politicus* correspond to the same man. Buchanan and Tullock (1962, p. 13) noted that collective action is essentially the aggregation of individual actions: “the action of individuals when they choose to accomplish purposes collectively rather than individually.” They assert that, whether in markets or political settings, individuals are predominantly self-interested

[1] Arrow (1950, 1951) taught us that the notion of the public interest is at best difficult to operationalize and at worst devoid of substantive content, primarily due to the technical challenges involved in aggregating individual preferences.

agents, driven by personal goals – both material and non-material. This is one of the main tenets of the public choice approach to the study of politics. It aligns with the methodological individualism favoured in the Austrian tradition, which traces its origins to Carl Menger (1871/1981) and was later advanced by Max Weber (1922/1978).

The market is a competitive environment, as is politics – a concept taken to extremes in Shakespeare's Hamlet. Just as an entrepreneur makes economic decisions that maximize their own interests in the form of profit, a politician follows the same path but with different means and ends – see Moreira and Alves (2004) for an illustration of this analogy, comparing the decision-making processes of politicians to those of entrepreneurs. Political choices are the joint product of individual choices by voters, lobbyists, members of interest groups, government executives, and other public servants. Public choice theory further integrates economic principles into the study of the political behaviour of these agents by insisting that "the same rational, self-interest-seeking motives that animate human action in ordinary markets be applied to decision-making in the public sector as well" (McChesney and Shughart, 1995, p. 9), modelling political behaviour on the assumption that these agents act in their self-interest, much like entrepreneurs in competitive markets.

This perspective does not negate the potential for governments to produce beneficial outcomes; rather, it emphasizes that what drives governments into doing good or bad is the direction in which incentives are aligned. Institutional arrangements can play a pivotal role in transforming self-interest into a harmony of interests between politicians and the public. Thus, the focus shifts from the moral character of specific actors to the structural incentives embedded within institutional frameworks. Constitutional rules, as foundational elements of institutional design, serve to shape these frameworks, guiding incentives and aligning individual interests with the broader public good (Buchanan and Tullock, 1962).

3. On the Nature of Knowledge: Markets and Politics

The availability of the necessary knowledge for economic coordination is contingent upon the institutional context. Different forms of economic organization are not equally effective in creating and transmitting that knowledge (Hayek, 1945; Boettke, 1997). This is so because that "knowledge […] never exists in concentrated or integrated form" (Hayek, 1945, p. 519). Rather, it exists in "the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess" (ibid). Knowledge about market opportunities, for instance, is unevenly distributed, often tied to specific circumstances of time and place, making it not only dispersed, but also both contextual and subjective. Indeed, knowledge about the preferences of individuals, their expectations, and the trade-offs they actually face is necessarily subjective. Furthermore, a significant portion of this knowledge is tacit. Not only it is non-articulated, but also non-propositional, thereby making it difficult or even impossible to communicate it linguistically. It was in the context of the Socialist Calculation Debate of the 20th century that economists began to systematically explore the problems posed by the nature of knowledge. That debate addressed the comparative performance of different economic systems in creating and harnessing the fragmented, subjective, and tacit knowledge possessed by individuals (Levy and Peart, 2008).

3.1. How does the market economy handle the knowledge problem?

The economic problem of a community is that of constantly choosing what to produce, how to produce, and how to distribute the results of production. A satisfactory solution to this problem is one in which the agents' preferences are fairly satisfied. However, ideally, any amount produced should use the smallest possible amount of inputs; i.e., besides satisfying consumer preferences (allocative efficiency), production should also be technically efficient.

To solve the economic problem of the community, it is necessary to have a system of allocation which directs the production efforts and a way to discover the best production projects that yield the desired output for the satisfaction of desires (Lourenço and Graça Moura, 2018). The market is a process of both allocation and discovery.

Individuals interact in the market in a decentralized fashion. Although there may be influences such as network externalities (Katz and Shapiro, 1985) or bandwagon and snob effects (Leibenstein, 1950), essentially they independently decide what to consume and how to obtain income (i.e., how to contribute to production). In making those decisions, individuals react to prices. Producers select what to produce and how to produce based on the prices of available resources and the market price of the output. Similarly, consumers decide what and how much to consume based on the trade-offs they face given their income, market prices, and individual preferences. Mises (1920) details that through the interaction of consumers, producers, and owners of the means of production, market prices are updated in accordance with relative scarcities. Individuals then adjust their decisions based on these prices. The pricing system that emerges through market interaction within an institutional arrangement – which includes, among other things, private property rights – is what enables individuals to value means and ends. Agents can rationally choose courses of action by comparing relative prices and allocating the resources accordingly (Mises, 1922).

Market prices act as signals for economic action. If a given commodity becomes scarce for any reason, its relative price tends to rise, signalling to consumers that they should economize on that commodity and to producers that they should mobilize resources toward its production (Jevons, 1871). Note that the information about the relative scarcity of the commodity is relayed through the economic system by price signals even without the affected individuals being consciously aware of such facts. Individuals act as if they were explicitly (and even linguistically) informed about the scarcity, but they do so in response to the incentives created by market price signals. The disperse and subjective knowledge is continuously shared and renewed, allowing producers to identify – and discover – what to produce and best production method to deploy in the production of consumer goods (Hayek, 1945). And similarly for consumers.

Market prices are vehicles for dynamic transportation of knowledge, thereby enabling the determination of the value of means and ends. To the extent that prices express the aggregate outcome of the multiple exchange values, they serve as a primordial tool for rational economic decision-making. Thus, without market prices, the necessary knowledge could hardly be relayed. The market process is essential to solve the economic calculation problem (Hayek, 1940).

3.2. The knowledge problem is also relevant for the study of political phenomena

In the preceding discussion, we argued that successful economic coordination is contingent upon the transmission of the dispersed, contextual, subjective, and tacit knowledge that individuals possess and create through market interactions. Now, we want to suggest that these attributes of knowledge are equally present in the knowledge generated and utilized by political actors – including legislators, executives, voters, and interest groups – in the political sphere.

In Section 2, we argued that politicians tend to behave according to their private interests. The most obvious of these is, of course, the goal of remaining in power. Bueno de Mesquita et al. (2003) addressed the problem of 'political survival' by studying the relationship between the leader and his supporters. In a model applicable to both democratic and autocratic regimes, they demonstrate that, to remain in power, a leader must secure a winning coalition – a subset of the electorate that enables the leader to ascend to and maintain power, expecting special privileges in return. Political leaders secure the support of a winning coalition through a process of political exchange. Specifically, leaders use – or promise to use – the coercive powers of the state to extract resources from the economy, a portion of which is distributed as rents in exchange for political support.

Of course, the capacity of the leader to extract resources is limited, while the potential uses of rents are unlimited. Thus, the leader must engage in some form of political calculation. Abdukadirov (2010) defines political calculation as the process through which politicians determine the value of the political support provided by supportive factions. To be efficient, the distribution of rents cannot be uniform if the value of political support provided by different factions is distinct.

To solve his political calculation problem, the leader faces a challenge: there is no inherent mechanism to evaluate the relative power or value of his supporters and, consequently, their fair share of rents. This is because the necessary information is dispersed among the members of existing factions. Moreover, the leader has no immediate access to citizens' preferences regarding his government.

In light of this, political leaders in both democracies and autocracies often employ various feedback mechanisms. Elections, for instance, serve as tools for political calculation. If this is the case, then elections in autocratic regimes are not merely symbolic: "They provide the autocrat with a pricing mechanism that allows him to evaluate the relative strength of various political factions. Thus, elections help the autocrat to decide which factions should be included in the winning coalition and what their share of rents should be" (Abdukadirov, 2010, p. 369). Other feedback mechanisms include protests, legislatures, and professional and business associations (Acchiardo, 2019).

However, it is not only the leader who faces a knowledge problem. Members of the winning coalition also encounter difficulties: they can hardly estimate the relative value of their support. Additionally, potential challengers to the leader, especially in autocracies, struggle to assess the level of support the leader enjoys.

A fruitful approach to the study of political phenomena must consider the insights on the nature of knowledge that were uncovered in the study of the market processes. Indeed, politics seems to be a special kind of market (Wagner, 2016). Although rent-seeking, lobbying, and the electoral mechanism are not strictly market actions, they are still guided by market forces such as competition, with rivalry adding intensity to these interactions.

4. Conclusion

Public choice theory has challenged the notion of political actors as benevolent guardians by demonstrating that self-interest is also a fundamental driver of political decision-making. This view highlights the parallels between political behaviour and market behaviour, particularly the role of incentives in shaping political actions. This short note has reviewed arguments from the economic literature based on these parallels, focusing on the knowledge problem faced by both economic and political agents. In fact, while political and market spheres are often treated as distinct, the challenges they face in terms of knowledge generation, transmission, and utilization display similarities. Understanding these similarities provides insights into how these systems function.

Just as the dispersed, tacit, and context-dependent nature of market knowledge complicates efficient central planning, political leaders and actors face similar barriers in understanding the preferences of citizens and supporters. Recognizing that politics operates under the same knowledge limitations as markets has important implications. For instance, it shifts our focus from the morality of individual leaders to the importance of designing institutional frameworks that align incentives with the public interest. Accounting for these insights enables a more realistic analysis of political phenomena. This may be particularly important at a time when technological developments are escalating the capabilities of mass control systems.

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