THE THEORY OF PUBLIC GOODS: MISPLACED EMPHASIS?

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The note takes up for critical examination the tendency in the modern theory of public goods to emphasize the problem of correct revelation or concealment of preferences. It is argued that a strategy which consists in playing down one's preferences for a public good in order to get a lower share in the costs of providing the good is not likely to succeed in an open political decision-making process involving elected representatives. This conclusion is supported by the fact that there seems to be little empirical evidence which shows the importance of the preference revelation issue.

The theory of public goods seems to concentrate more and more on the problem of whether individual members of a group or society are willing to reveal correctly their preferences about public goods. Since each member knows that many other members are interested in having the public good, and furthermore no one can be excluded from benefiting from the public good once it is there, everyone may hope to become a 'free rider', i.e. to benefit from the public good without having to share the costs involved. If a collective decision mechanism, involving bargaining and/or voting, is used, if furthermore decisions are taken simultaneously with regard to the amount of public goods and the corresponding costs, and if finally the mechanism is such that a high preference for the public goods tends to imply a large share in the costs, then there is an incentive for everyone to pretend (falsely) not to have any high preference for the public goods. The outcome of the process may then be very far from optimal in every sense of the word.

The logical and theoretical problems involved are of course interesting and deserve to be analysed. However, I feel that the present strong emphasis on this point is somewhat misplaced.

My main reason for thinking this is perhaps that I do not know of many historical records or other empirical evidence which show convincingly that the problem of correct revelation of preferences has been of any practical significance. I am thinking of decisions at the level of governments, states or counties, and municipalities, i.e. decisions where there is a political process involved. There are other organizations of a smaller scale – such as private clubs of various sorts, small residential cooperatives and perhaps families – which encounter joint
decision problems similar to the public goods problem. In such cases one does perhaps more often observe distorted representation of preferences.

Now one might argue that it is implied by the nature of the issue that historical records and empirical evidence would never be available, if the persons and parties involved are efficient and consistent in misrepresenting their preferences. I do not, however, consider this to be a convincing argument. If the theory of concealment of preferences were correct, then practically everyone involved in public affairs would be a practitioner of the art, and he would probably understand that everyone, friend and foe alike, was practicing the same tricks. Add to this the fact that many people like to reveal misbehaviour of their adversaries and boast of tricks performed by themselves if they have been successful. Then it is hard to believe that we should not get ample empirical evidence if concealment of preferences were as important in practice as it seems to be in theory.

To this observation we might add the fact that we have a lot of public goods around, probably more than we would expect on the basis of the theory of the free rider tendency in connection with public goods, and there are also many groups and individuals around who by no means appear to conceal their preferences for public goods.

For these sketchily presented reasons I think there is a need for a re-examination of the present trends in the theory of public goods.

In such a re-examination a first query should perhaps be about honesty versus dishonesty. Economic theory, in this as well as in some other fields, tends to suggest that people are honest only to the extent that they have economic incentives for being so. This is a *homo oeconomicus* assumption which is far from being obviously true, and which needs confrontation with observed realities. In fact, a simple line of thought suggests that the assumption can hardly be true in its most extreme form. No society would be viable without some norms and rules of conduct. Such norms and rules are especially necessary for viability in fields where strictly economic incentives are absent and cannot be created. Some degree of honesty in various sorts of communication is one such example, and it might have at least some bearing upon the problem of collective decision-making about public goods.

Closely related to this argument is the consideration that everybody would understand that the system would produce very bad results and possibly come to a breakdown if everybody concealed their preferences for the public goods. Although concealment of preferences corresponds to a sort of non-cooperative equilibrium, and thus to individual rationality in the narrow sense, everybody would realize that it generates a very inferior solution. The collective might be able to break out of this equilibrium and instead establish something more like a cooperative equilibrium, based on more true representations of preferences, out of a joint understanding of the necessity of this for the long-run workability of the system. There are many avenues which could be (and partly have been) explored in this field.
Nevertheless, it seems to me that the clue to the unimportance of the problem of misrepresentation of preferences lies elsewhere, namely in the existence of at least two tiers in the decision system.

Let us briefly consider the case where we have 'ordinary' members of society constituting an electorate. They elect politicians who constitute a decision-making body, deciding on public goods and corresponding costs. In such a system there are several factors which prevent misrepresentation of preference and the prevalence of the free rider problem.

For analysing such a system we must consider both the revelation of preferences on the part of the politicians, and on the part of the general public.

What matters for the actual decision is the revelation of preferences by the politicians in the actual decision-making process. Could a politician misrepresent his preferences in the decision-making body in order to reduce the cost share levied on the group which he represents?

I think there are several reasons why he will usually not do so.

In the first place, preferences are not always clear before the process starts. The decision-making body is not simply a vote-counting mechanism; it is a living organism with exchanges of views and attempts to persuade opponents. If one representative is in favour of a certain amount of public expenditure, he may not feel confident that the other ones (or sufficiently many of them) are in favour of the same policy so that he can withdraw from the issue and enjoy a position as a free rider. There is then an incentive for him to try to persuade others, and in this process he reveals, at least partly, his own preferences.

The next point refers to the relationship between the politicians and the electorate. Suppose a politician tried the trick of misrepresenting his preferences in the decision-making body in order to benefit as a free rider, and assume that 'his' electors have in fact high preferences for large amounts of the public goods. If his electors were very shrewd and sophisticated, then they might understand the tactical reasons for the behaviour of their representative. However, this would hardly be a stable situation. If not only this representative, but most of the other ones as well, misrepresent their preferences, then the practical outcome would be very bad. It is hard to believe that the politician could defend himself successfully on the background of such a result. As another, and more favourable example, let us assume that some politicians who are in favour of large amounts of public goods conceal their preferences with a successful result, i.e. there are enough of other politicians who carry the proposals for large public expenditures through and who also accept that their supporters have to shoulder a relatively large cost burden. Now an interesting question is: Which of the politicians will gain more support from the electorate, those who concealed their preferences or those who presented their preferences honestly?

Theoretically it is of course possible that those politicians who concealed their preferences have a tacit agreement with some groups of electors. These electors might vote for the politicians, knowing that they are going to play the trick, and
then of course continue to support the same politicians when the trick has been played successfully. However, such tacit agreements with a sufficiently large group of electors would rarely be feasible in practice. If there is an open election campaign, with competition for votes, then the politicians who speak out openly in favour of large public expenditures would probably win the votes of those electors who are in fact in favour of such expenditures.

A politician might of course try to speak in favour of large expenditures on public goods when he talks to the electors, but conceal his preferences for such expenditures in the decision-making body. With the degree of openness surrounding most types of decisions about public expenditures such a strategy would hardly be profitable.

It seems then that a politician who is in favour of large expenditures on public goods (or who is indifferent, but trics to find a platform for his election) will usually have to speak out in favour of large expenditures on public goods in talking to his electorate, and will have to stick to this, of course with some tolerance, when it comes to actual decision-making.

A closer examination requires a more careful specification of the conditions and circumstances in which the decisions are to be made.

The most favourable case for a politician who will try to make a gain for his group by concealing his preferences, is the case where a group can be identified by other criteria than the preferences in question, and where members of the group have common interests over a broad range of issues. Farmers, workers, capitalists may elect representatives who are known to promote their interests in general, rather than electing representatives on the basis of their open and explicit standpoints towards specific issues such as the extent of specific public goods. In such cases concealment of preferences may be an attractive strategy for several reasons. Since the groups can be identified by 'objective' criteria, there are practical possibilities of letting a group, which appears not to favour a certain public good, bear a light share in the corresponding tax burden. Furthermore, the electors may be satisfied with their representatives if the total outcome is good for them, without caring so much about what they say and what tactical moves they make, and group identification makes it easy to uphold a 'tacit agreement' as suggested above.

On the other extreme we might think of a society which is rather homogeneous apart from the fact that people have different preferences with regard to the amount of a certain public good. These preferences are then not closely correlated with any other objective criteria. In this case politicians must compete for votes on the basis of the collective goods issue, and the arguments adduced above about the difficulty of pursuing successfully the strategy of concealing the true preferences come into full play. Furthermore, another point of a somewhat different nature then also enters the picture. It will, in such a case, at least when there is secret ballot, be impossible to implement a tax burden discrimination between groups of people according to their preferences referring to the public
good. The numbers of votes count in deciding the strength of the representation of different views in the decision-making body, but the votes cannot be used as a basis for tax discrimination. (A possibility of partly overcoming the latter difficulty is opened up if the enjoyment of a public good is strongly complementary to the consumption of a private good, a case which has recently attracted some interest.)

In most realistic cases the situation is somewhere between the extremes here described. It seems clear then that the two-tier system of electors and representatives tends to diminish the significance and relevance of the theoretical problem of unwillingness to reveal preferences for public goods. The issue cannot be settled unconditionally on a purely theoretical or speculative basis since there are, as suggested above, conceivable cases where the trick of concealing the true preferences may be played successfully. Accordingly it is all the more important to refer the issue to empirical scrutiny.

I suggested above that it is hard to find empirical evidence which shows the relevance of the revelation issue. The best examples (in Norway) are probably to be found in decision-making about public goods which require joint undertakings by more than one municipality, but which are not referred to the national level. Examples may refer to water supply, some schools and cultural institutions, sewerage systems, etc. In such cases the issues are subject to negotiations between the municipalities. Some of the factors which counteract the tendency towards misrepresentation of preferences in ordinary processes are then more or less removed: the connection with elections and competition for votes is more indirect partly because representatives do not compete for votes across the boundaries of the municipalities; the groups behind the negotiators are well defined by geographical boundaries, and have more or less common interests in the issue; and the division of the total burden is a clear-cut issue, any pattern of burden-sharing being implementable through the tax and transfer system and the agreements concerning the financing of the joint undertakings. Consistent with this, the general impression gained by observing such negotiations is that false pretensions play a larger part in such decision-making processes than in ordinary cases which involve only one constituency or the whole nation, i.e. it seems that representatives of a municipality in negotiating with other municipalities play down their interest in a joint undertaking as a strategy towards achieving a smaller share in the total cost. However, for reasons already alluded to this remains an impression rather than a well documented fact.

Most of the points made above are in need of further clarification and elaboration. (This is of course not a question of beginning from scratch; there is much of relevance to be found in analyses of political processes, game theory, etc.) The purpose of the present note is, however, very limited. It is simply to call into question the relevance of the problem of concealment of preferences in connection with the bulk of public goods. To me it seems that the evidence is
largely against the relevance of the problem, although it may play a part in some corners of the full space of different decision-making processes about public goods. Since the problem is 'threatening' to become the focal point of the theory of public goods, I think we ought to re-examine the matter before we continue further in the same direction.