COMPETITION AND DEMOCRACY*

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ECONOMISTS have often argued that if an industry acts as a monopolist it would be desirable government policy either to break up the monopoly or, if this is undesirable because of increasing returns, to regulate and perhaps even nationalize it.[1] This proposition, although extremely well known and often accepted as obvious, turns out upon close examination to be far from obvious, and to involve several assumptions of doubtful validity. The argument supporting this proposition goes something as follows: Monopolies cause a maldistribution of resources, since the price charged by a monopolist exceeds marginal costs and an optimal distribution requires price equal to marginal cost. An optimal allocation would occur if the industry were made competitive, since price equals marginal costs in competitive industries. If the industry were a "natural" monopoly, price could be made equal to marginal cost either indirectly by government regulation or directly by government administration. Therefore, the recommendation is an anti-trust law to prevent or break up contrived monopolies and government regulation or government administration of natural monopolies.

The non-sequitor in this argument is the sentence beginning with "therefore"; the recommendation of government intervention does not follow from the demonstration that government intervention could improve matters. Demonstrating that a set of government decisions would improve matters is not the same as demonstrating that actual government decisions would do so. This kind of inference is logically equivalent to identifying the actual workings of the market sector with its ideal workings.

In Section I a theory of the workings of a political democracy under ideal conditions is developed. It is shown that an ideal democracy is very similar

* A draft of this paper was written in the summer of 1952, but pressure of other work prevented me from revising it for publication until the summer of 1957. In the interval, an article using a similar approach was published by Anthony Downs, An Economic Theory of Political Action in a Democracy, 67 J. Pol. Econ. 135 (1957); however, our work does not overlap too much, since Downs emphasizes somewhat different aspects of the political structure than I do here.

[1] Henry Simons vigorously argued that all "natural" monopolies (i.e., monopolies caused by increasing returns) should be nationalized by the state; see his A Positive Program for Laissez-faire, reprinted in Economic Policy for a Free Society (1948).

to an ideal free enterprise system in the market place. That is, political decisions would be determined by the values of the electorate and the political sector would be run very efficiently. Section II tries to determine why actual democracies differ significantly from the ideal, and whether government regulation of private monopolies in actual democracies would improve matters.

I. Competition in Ideal Democracies

An ideal political democracy is defined as: *an institutional arrangement for arriving at political decisions in which individuals endeavor to acquire political office through perfectly free competition for the votes of a broadly based electorate.*[2] Three aspects of this definition warrant some discussion. No country could legitimately be called a political democracy unless a large fraction of its population could vote. Although "large" is a matter of degree, it is clear that countries have differed greatly; for example, 17th century England had much too narrow a franchise to qualify as a political democracy.

It is often said that the transfer of activities from the market place to the political sector would reduce the role of competition in organizing activities. In a political democracy individuals (or parties) do compete for political office—in, say, periodic elections—by offering platforms to the electorate. In an ideal political democracy competition is free in the sense that no appreciable costs or artificial barriers prevent an individual from running for office, and from putting a platform before the electorate. The transfer of activities from the market to the state in a political democracy does not necessarily reduce the amount of competition, but does change its form from competition by enterprises to competition by parties. Indeed, perfect competition is as necessary to an ideal political democracy as it is to an ideal free enterprise system. This suggests that the analysis of the workings of a free enterprise economy can be used to understand the workings of a political democracy.

The immediate aim of any political party is to be chosen by the electorate, just as the immediate aim of any firm is to be chosen by consumers. This immediate aim of the firm is consistent with a wide range of ultimate aims, such as the desire to help consumers (altruism) or the desire for economic power; the one most consistent with available data and most frequently used is the desire to maximize income or "profits." Likewise this immediate aim of the political party is consistent with many ultimate aims, such as the desire to help one's country (altruism) or the desire for prestige and income; the one most frequently used[3] is the desire for power, which can be defined as the ability to influence behavior of others. Most of this paper requires only

[2] For a similar definition, see J. Schumpeter, Capitalism, Socialism and Democracy, p. 269 (1942).

[3] See, for example, A. Kaplan and H. Lasswell, Power and Society, p. 75 (1950).

an assumption about the immediate aim of parties; at several points, however, the analysis is also related to some ultimate aims.

This definition has several important implications. First, it is easy to show that there must be freedom of speech and expression in ideal democracies. If an individual is free to offer a platform to the electorate, he is free to criticize the platform of others. Unless all possessed at least as much freedom as candidates they could increase their freedom merely by running for office. Since this situation is unstable they would ultimately have to possess as much freedom as candidates do.

Another important implication of this definition can be shown most simply by assuming that all voters have the same preferences. If the party in office did not adopt the policies preferred by the electorate, another party could gain more popular support by offering a platform closer to these preferences. Consequently, the only equilibirium platform would be one that perfectly satisfied these preferences. An ideal political democracy would be perfectly responsive to the "will" of the people. The ultimate aim of each party may be to acquire political power, but in equilibrium no one, including those "in power," has any political power.[4] There is no room for choice by political officials because political decisions are completely determined by electorate preferences. This theorem casts light on the controversy of whether a representative should vote according to his own dictates or according to the will of his constituents.[5] In an ideal democracy unless he follows the "will" of his constituents, he does not remain in office very long.

Third, in an ideally competitive free enterprise system, only the most efficient firms survive; for example, if the level of a firm's costs were independent of output and varied from firm to firm, only the firm with the lowest costs would survive. Similarly, in an ideal democracy only the most efficient parties survive; if the costs incurred by the state in operating an industry were independent of output and dependent on the party in office, only the party with the lowest costs could remain in office. An industry would be operated equally efficiently by the state and by the market place if the most efficient party had the same costs as the most efficient firm. This does not merely state—as the analysis by Lange of socialism does—that the political sector conceptually *could* reproduce the free enterprise equilibrium, but that it would do so. The costs of the most efficient party and most efficient firm may differ if different individuals are drawn into political and market activity. Private enterprise would operate an industry more efficiently than the state only if the most efficient firm had lower costs than the most efficient party, and vice versa.

[4] Similarly, in a full market equilibrium no firm makes any "profits" although each may be motivated by a desire for profits.

[5] The classic statement of one viewpoint is contained in Burke's speech to the electors of Bristol in 1774.

II. Competition in Actual Democracies

There is relatively little to choose between an ideal free enterprise system and an ideal political democracy; both are efficient and responsive to preferences of the "electorate." Those advocating a shift of activities from the market place to the state must argue that the actual enterprise system is far from ideal because it contains numerous monopolies and other imperfections. Those advocating a minimum number of state activities must argue that the actual political system is even further from the ideal. Imperfections in the market place have elsewhere been discussed extensively, so we can concentrate on some important political imperfections.

Since each person has a fixed number of votes—either 1 or 0—regardless of the amount of information he has and the intelligence used in acting on this information, and since minorities are usually given no representation, it does not "pay" to be well-informed and thoughtful on political issues, or even to vote. An efficient party may be unable to convince enough voters that it is more efficient than other parties. In the market place minorities have "representation" and the number of "votes" a person has is related to his "proportioned productivity," so the incentives to act wisely are greater here than in the political sector. Therefore, it is relatively easy for an efficient firm to survive since it need only gain the support of creditors and consumers who have a direct personal interest in making wise decisions.

Political competition is reduced by the large scale required for political organizations. Candidates for many offices, such as the Presidency and State Governorships, must have enough resources to reach millions of voters. Many groups that would like to compete for these offices do not have sufficient resources to reach large numbers of voters. Although it is sometimes necessary for a firm to organize on a national or state basis, this is clearly less important in the market sector than in the political sector. The scale of political activity is large, also, because many offices tie together numerous activities. A candidate who knows how to run the Post Office efficiently must convince voters that he knows something about immigration policy, public utility regulations and a host of other problems in addition to post-office administration. This tie-in of activities may prevent persons who are efficient at one activity only from running for office. Tie-ins are also found in the market place but since they cover relatively few activities, a firm can usually specialize in the product or process at which it is most efficient. Since an ideal democracy as well as an ideal enterprise system has an optimal separation of activities, it is somewhat puzzling that tie-ins are much more important in the political sector. I suspect that an electorate with a limited amount of political information finds it easier to place one person in charge of many activities than to choose one person for each activity.

Although ignorance and the large scale required of political organizations are perhaps the two most potent forces producing monopoly and other imperfections in democracies, periodic rather than continuous elections, and different preferences among members of the electorate also do so.[6] I am inclined to believe that monopoly and other imperfections are at least as important, and perhaps substantially more so, in the political sector as in the market place. If this belief is even approximately correct, it has important implications for the query which opened this essay; namely, does the existence of market imperfections justify government intervention? The answer would be "no," if the imperfections in government behavior were greater than those in the market. It may be preferable not to regulate economic monopolies and to suffer their bad effects, rather than to regulate them and suffer the effects of political imprfections.

[6] For relation between political tie-ins and different preferences among the electorate see my The Economics of Discrimination, pp. 64–66 (1957).