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**SCHUMPETERIAN POLITICAL ECONOMY  
AND DOWNSIAN PUBLIC CHOICE:  
ALTERNATIVE ECONOMIC THEORIES  
OF DEMOCRACY**

**MICHAEL WOHLGEMUTH**

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# **Schumpeterian Political Economy and Downsian Public Choice: Alternative economic theories of democracy**

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**Abstract:** Joseph Schumpeter is often regarded a founder of Public Choice. Looking closely at mainstream Public Choice and Schumpeter's writings on democracy, this claim is rejected. But I not only want to "get the history of ideas right". I also address some uneasy foundations (e.g. voter rationality in low-cost environments) and still neglected issues (e.g. political leadership and opinion-formation) of Public Choice theory. First, Schumpeterian democracy as a competitive struggle for leadership is contrasted with Downsian models, where parties adapt to given median positions within given issue spaces. Then, areas of research are identified that do address Schumpeterian issues: (cognitive) economics of bounded political rationality and (evolutionary) economics of political leadership and opinion formation. **JEL:** B2; B4; D7

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## 1. Introduction

*“No one ever knew quite what to make of this neat saturnine man with a taste for dramatic prose and theatrical gestures. He was undoubtedly brilliant – but he was perplexing”* (Robert L. Heilbroner 1953, 302 about Schumpeter).

Joseph Schumpeter is often regarded a pioneer, if not founder of Public Choice or the economics of politics.<sup>1</sup> Looking back at the development of mainstream Public Choice and looking closely at Schumpeter’s own writings on democracy (and on the limits of static equilibrium analysis), this seems rather odd. There may be a hidden irony in the history of ideas which only few observers<sup>2</sup> have uncovered in its manifold aspects.

Usually Schumpeter is only *mentioned* as a precursor, but hardly ever quoted in his own words. Already Downs (1957) in probably the most influential book in its field is a telling case when he states: „Schumpeter’s profound analysis of democracy forms the inspiration and foundation of our whole thesis, and our debt and gratitude to him are great indeed” (ibid., 29, fn. 11). In the whole thesis, however, Schumpeter is only mentioned two times with the same quote describing his general approach which regards social functions of politics as incidental by-products of the competitive struggle for power and office. Schumpeter’s core assertions on irrationality in politics and the vital role of political leadership are neither mentioned nor accepted. Still, it has become „common to talk about the ‘Schumpeter-Downs’ theory of democracy“ (Udehn 1996, 18). It may be even more puzzling to find Wittman (1995, 23, fn. 5) paying equally unqualified tribute to Schumpeter in his “Myth of Democratic Failure” – one of the most outspoken denials of Schumpeter’s view published so far.

This paper wants to show fundamental differences between Schumpeter’s theory of democracy and mainstream Public Choice. The main motivation is not to just “get the history of ideas right” but to address methodological issues which are increasingly recognised as uneasy foundations of Public Choice (such as bounded rationality in low-

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<sup>1</sup> See e.g. Becker (1958, 105), (1985, 120ff), Buchanan (1987/88, 131), (1999, 20), Buchanan and Tullock (1962, 335), Coe and Wilber (1985, 28), Mueller (1989a, 2), (1997, 6), Reisman (1990, 8, 300), Almond (1991), McNutt (1996, 2), Rose and McAllister (1992, 117), Stolper (1994, 209), Kinnear (1999, 932), or Bernholz (2000, 4, 7).

<sup>2</sup> See Mitchell (1984), Frey (1981), Swedberg (1991), or Prisching (1995).

cost decision environments) and themes which have been largely neglected by Public Choice (such as political leadership and opinion-formation). The intention is neither to praise nor to bury Schumpeter. It is to point at political economy issues that a progressing paradigm will need to address anyway and that it might address in a more or less Schumpeterian spirit.

In part 2, Schumpeter's "Another Theory of Democracy" (1942/87, ch. xxii) is shortly presented. In part 3, I argue that both elements so crucial and dominant in Schumpeter's account: citizens' irrationality and politicians' leadership are turned to their almost complete opposites in Downs' "Economic Theory of Democracy" (1957) and the ensuing theories of spatial voting. I also show that Downs' model of "rational ignorance", while at first glance Schumpeterian, is strikingly different from Schumpeter's understanding of human nature in politics. In part 4, two major issues on a research agenda of political economy are presented which may in fact claim Schumpeter as a precursor: a (cognitive) economics of bounded rationality in politics, and an (evolutionary) economics of political opinion formation. Part 5 is a short outlook. Again: this is not a Schumpeterian critique of the whole Public Choice enterprise. It is a confrontation of two assessments of democracy: the Schumpeterian view and the spatial voting model.

## **2. Democracy: Schumpeter's view, the classical doctrine and the neoclassical model**

*"our chief troubles about the classical theory centered in the proposition that 'the people' hold a definite and rational opinion about every individual question and that they give effect to this opinion – in a democracy – by choosing 'representatives' who will see to it that that opinion is carried out"* Joseph A. Schumpeter (1942/87, 269).

It may be borne in mind that Schumpeter's discussion of democracy (1942/87, part IV) complements his predictions that capitalist civilisation is doomed (part II) and that socialist planning is the wave of the future (part III). With the benefit of hindsight, both predictions failed so far – thus also eliminating chances to test his claimed non-incompatibility of socialism and democracy (e.g. *ibid*, 284). This is not the place to discuss these perplexing ideas. Irrespective of Schumpeter's daring predictions based on an unconventional blend of romantic conservatism and Marxist historicism, his account of the dynamics of capitalist systems and his unromantic model of democracy are of lasting

value for modern economics. The question remains: how far has modern economics and, in our case: modern Public Choice, really Schumpeterian roots?

There are two common roots. First, modern Public Choice and Schumpeter largely share the same antagonists: those who explicitly or tacitly assume (a) that people act for the common good once they enter democratic decision making, and (b) that democratic government will maximise welfare once it knows (or is told by enlightened economists) how to do so. Second, most Public Choice scholars would have no problem to endorse Schumpeter's (1942/87, 269) definition of democracy as a method rather than an ideal:

“the democratic method is that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote”.

Very different from a mainstream Public Choice perspective, however, this “competitive struggle” is driven by political leadership instead of political deference to given voter distributions. Schumpeter (*ibid.*, 270) makes this point right at the outset:

“the theory embodied in this definition leaves all the room we may wish to have for the proper recognition of the vital fact of leadership ... collectives act almost exclusively by accepting leadership – this is the dominant mechanism of practically any collective action which is more than a reflex”.

Schumpeter adds that the “classical” theory of democracy “attributed to the electorate an altogether unrealistic degree of initiative which practically amounted to ignoring leadership” (*ibid.*). And the neoclassical economics of democracy?

In some respects, it reinstates more elements of the classical concept than Schumpeter's “other theory of democracy” would allow. To be sure, modern economics of democracy departs from classical idealism by *not* starting with idealistic assumptions about the *motives* of political behaviour. However, by attaching high standards of rationality to political actors, by treating political issues and preferences as given and by modelling political competition as a state of affairs in which politicians passively adapt to a given majority will, much of Public Choice remains ironically close to rationalistic and idealistic traditions which linked democracy to given expressions of a “*volonté générale*”. As a result, much of the eighteenth-century ideal of democracy is only revamped in equilibrium terms. Schumpeter (*ibid.*, 250) defined the classical doctrine as

“that institutional arrangement for arriving at political decisions which realizes the common good by making the people itself decide issues through the election of individuals who are to assemble in order to carry out its will”.

Clearly, politicians in the Public Choice perspective do not assemble with the *intention* to carry out the people’s will. But, in most demand-driven models of democracy, their intention to maximise votes usually produces the *outcome* that they are forced to carry out the will of the median voter. And more often than not these results are interpreted as “Pareto efficient” – welfare economists’ favourite expression of “the common good”.

Hence, there are reasons to suspect mainstream economics of democracy to be much more “classical” in spirit, but not in style – whereas Schumpeter’s argumentation is classic (less “economic”, more “prosaic”) in style, but his departure from the classical spirit is much more radical in fact. Two major aspects distinguish Schumpeter’s theory of democracy most clearly from the classical doctrine *and* from the neoclassical model:

(1) political leadership and (2) irrationality in politics.

## **2.1 political leadership**

In Downsian spatial voting models (but also Chicago-style efficient political markets, Arrowian social choice, or most of contractarian constitutional economics), collectives act almost exclusively through politicians who take citizens’ preferences as given. Just as in the neoclassical model of “perfect” competition prices and homogenous goods are given and not created in the competitive process, preference distributions and issues are “given” in most economics of politics. In both cases, entrepreneurship and the introduction of “new combinations” have no room. Strictly adhering to the neoclassical pure logic of choice, Public Choice is barred from recognising the Schumpeterian view that politicians act as entrepreneurs who create and change voters’ preferences and opinions, or introduce new political products and forms of organisation. Voter preferences, according to Schumpeter (1942/87, 282f), “are not the ultimate data of the process that produces government”. The electorate’s choice “does not flow from its own initiative but is being shaped, and the shaping of it is an essential part of the democratic process”. Hence, the “psycho-technics of party management and party advertising, slogans and marching tunes, are not accessories. They are of the essence of politics. So is the political boss”.

Exactly these essential elements of the democratic process are hardly accepted even as accessories in spatial voting models which are clearly dominated by the view of politicians as passive retailers of given voter preferences. Contrast this again with Schumpeter's view that political leadership has "only a distant relation, if any, with 'seeing that the will of the people is carried out' ... Precisely in the best instances, the people are presented with results they never thought of and would not have approved in advance" (ibid., 278). Precisely these instances can, by their very nature, not be accounted for in demand-driven equilibrium theories of the economics of politics.

## 2.2 political irrationality

If ever there was a common "hard core" of the entire Public Choice paradigm, it is the assumption of rational conduct of all actors involved. And if ever there was a "revolutionary" claim of Public Choice, it is to break with the notion of "bifurcated man" who, as soon as he enters the political field, would display standards of behaviour which differ from those employed in market transactions. After all, that's what the *economics* of politics is all about: the universal application of the basic behavioural assumptions of *homo oeconomicus* (e.g. Buchanan 1972; Downs 1957, 4ff; Mueller 1989a, 1).

Schumpeter in fact denies this. In sharp contrast to what would later become the hard core of modern Public Choice - *and* to what he identifies as the "requirements of the classical doctrine" (ibid., 261), he allows for a great deal of utter irrationality as a consequence of human nature and permissive circumstances, e.g., when he argues that:

"the typical citizen drops to a lower level of mental performance as soon as he enters the political field. He argues and analyzes in a way he would readily recognize as infantile within the sphere of his real interests. He becomes a primitive again" (ibid., 262).

Lack of mental effort, of rational calculation and consistent reasoning not only describe Schumpeter's citizen-voter who, as a "member of an unworkable committee, the committee of the whole nation" (ibid., 261), has no impact on collective decision-making and who can thus take a free ride on others' decision-making (and must take a forced ride on collective outcomes). Lower levels of mental performance and pathologies of crowd-behaviour even characterise Schumpeter's professional politicians, only in a somewhat milder form (see ibid., 257).

Schumpeter not only rejects to use mainstream rationality assumptions for his study of politics. What is more, he does not apply the *same* rationality assumptions for explaining political and economic phenomena but insists that “(t)here is no such thing as a universal pattern of rationality” (ibid., 258, fn. 10). Whereas today’s standard procedure of economics is to explain different behaviour only as a consequence of different cost-benefit ratios or different restraints to action, but never to change the rationality assumption in the process, Schumpeter feels no inhibitions to do just that. As a consequence, he “came ‘dangerously’ close to treating people as having ... ‘bifurcated minds’” (Mitchell 1984, 76). And it is fair to conclude that “(b)ecause of this near-bifurcation in the choice of basic axioms Schumpeter has not influenced Public Choice“ (ibid.).

It may be outré to bestow upon Schumpeter the dubious title „founder of irrational choice theory“ (Prisching 1995). But with regard to his theory of democracy, irrationality is a crucial element which is unduly ignored when celebrating Schumpeter as founder of a rational choice dominated economics of politics. The differences will become clear, if I now contrast Schumpeter’s theory of democracy with one of the most influential early contributions to modern Public Choice.

### **3. Schumpeter vs. Downsian median voter logic**

*“What strikes me most of all and seems to me to be the core of the trouble is the fact that the sense of reality is so completely lost”* Schumpeter (1942/87, 261).

As Holcombe (1989, 115) observed, economists’ „median voter model in the public sector has served in much the same role as the model of pure competition in the private sector“. And it can be exposed to much the same Schumpeterian critique. Schumpeter repeatedly made the point that social development which is driven by the process of creative destruction and entrepreneurial innovation is ruled out in the model of “pure” or “perfect” competition. Indeed, “all the essential facts of that process are absent from the general schema of economic life that yields the traditional propositions about perfect competition” (1942/87, 104). Most importantly, the entrepreneur who introduces new combinations and thus creates disequilibrating forces “has no function of a special kind

here, he simply does not exist” (Schumpeter 1912/34, 76). The same is true for spatial competition models in the Downsian tradition.<sup>3</sup>

### 3.1 “political leadership” vs. “spatial voting”

It was Downs’ aim and achievement to “treat government as an endogenous variable in general equilibrium theory” (1957, 280). By combining vote-maximising political competitors and utility-maximising voters with given preferences within a given issue-space, election outcomes could be deduced as equilibria under varying structural assumptions. In its “perfect” form of two-party competition along a one-dimensional issue space with perfect knowledge and single-peaked preferences, election outcomes are completely determined by the identical programme of both parties taking the position of the median voter. Hence, the vote-maximising politician finds itself in the same position as the profit-maximising supplier in the model of perfect competition: just as the latter is reduced to a passive price-taker, the former is reduced to an impotent “position-taker” who has to take the median voter’s preference as given and imperative.

But, in addition to recreating similar properties based on heroic assumptions, the political variant of perfect competition is haunted by internal tensions among its assumptions. While the assumption that citizens vote is necessary for having a median voter (theorem) and a democracy to speak of, it violates the assumption of voters’ instrumental rationality. Both major reasons for rational abstention: indifference and alienation are maximised under “perfect” political rivalry for the median voter. Hence, in equilibrium not only have rivalling substitutes vanished; the very act of voting becomes meaningless.

To be sure, Downs and his followers developed the basic model in many different directions by relaxing particular assumptions of the strict median voter model. This made it possible to adapt the model to various voting procedures, and optimal locations of more than two parties facing more than single-peaked preference distributions in a more than one-dimensional issue space were determined as more or less stable equilibrium states.<sup>4</sup>

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<sup>3</sup> The model was first introduced by Hotelling’s (1929) work carrying the characteristic title „Stability in Competition“. Black (1948) achieved its first full formulation for direct-democratic group decision making. But it was Downs (1957) who worked out the behavioural assumptions and structural conditions which allowed the theorem’s application to more complex cases of representative democracy.

<sup>4</sup> See Mueller (1989a), Rowley (1984), Shepsle (1991), Enelow/Hinich (1990) or Ordeshook (1997).

The basic conditions of vote maximisation based on given distributions of voters' given preferences along a given issue-space, however, remained largely unchanged.

The greatest efforts were invested in dealing with multidimensional issue spaces since it was discovered that multiple unstable outcomes can emerge, which, in addition, may not be Pareto-efficient (e.g. Mueller 1989a, 197ff). Candidates who know with certainty which policy will attract which voters („deterministic voting“), can always top the offer made by their rivals along multiple issues and thus upset equilibrium. As a consequence, the median voter was long regarded an „artefact“ of the assumption of the one-dimensional issue space (Hinich 1977). But meanwhile, with subtle variations towards “probabilistic voting”, stable equilibrium states were defined which, in addition, have the agreeable property of being welfare maximising.<sup>5</sup>

But as with other variations on the median voter theme, the state “appears as simply a voting rule that transforms individual preferences into political outcomes” (Mueller 1989a, 344). Competitive equilibrium still presupposes the parties' passive adaptation to voters' preferences and their distribution within a given interval of possible positions, which are equally identified and scaled by all actors (see Rowley 1984, 113). Another limitation is that many political issues can not be meaningfully scaled at all; they are „valence issues“ that voters value either positively or negatively but do not position in space (Stokes 1992). Already Schumpeter (1942/87, 255) argued that chances for elections to produce results which reflect “fair compromise” are

“greatest with those issues which are quantitative in nature or admit of gradation, such as the question how much to be spent on unemployment relief provided everybody favors some expenditure for that purpose. But with qualitative issues, such as the question whether or not to persecute heretics or to enter upon a war, the result attained may well, though for different reasons, be equally distasteful to all people whereas the decision imposed by a non-democratic agency might prove much more acceptable to them”.

Similar reasoning led Schumpeter (ibid., 291) to stress as a „condition for the success of democracy” that “the effective range of political decision ... has to be subject to constitutional constraints”. His account of the irrationality and irresponsibility of mass

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<sup>5</sup> With “probabilistic voting“ parties do not with the slightest move within the issue space lose or win clearly defined voters; they only affect probabilities of winning or losing votes. Now, vote maximising again drives both parties toward the same position within the given multi-dimensional probability space. The result equals that of a maximised Benthamite welfare function (Coughlin/Nitzan 1981; Ledyard 1984). The general validity of this potential reinstatement of democratic welfare functions is questioned on theoretical and empirical grounds by Kirchgässner (2000).

behaviour and voter conduct provides some justification for this claim – whereas in a world of rationality and spatial voting the very idea of limiting the „issue space“ and disenfranchising the median voter is quite inconceivable. This, again, may point at a communality of demand-driven spatial models of democracy and common-will driven ideals of the classical doctrine. But it may suffice here to note once more that the assumption of given voter preferences (be they deterministic or probabilistic) to which political entrepreneurs simply adapt displayed a remarkable persistence in a paradigm that marched out against the idealism of the classical doctrine.

Downs himself was among the first to observe that the selfish utility maximising actors of his model produce results that are not very different from those that the naïve idealist doctrines took for granted: “if our hypothesis is correct, the men in government achieve their own goals by carrying out those government actions which most please voters, just as entrepreneurs make profits by producing things people want” (Downs 1957, 292). Unlike many of his followers, however, Downs (*ibid.*, 177ff.) denies welfare-optimising, Pareto-optimal properties of his model – mainly as a result of having inquired deeper into the very characteristics of the production of political goods. It should also be mentioned that Downs regarded the presentation of his basic logic of voting in a general equilibrium framework as “only preliminary to the later analysis of behavior when uncertainty prevails” (*ibid.*, 13). And in this later analysis, he does address issues such as deliberately obscured platforms, ideological immobility, the emergence of new parties, and even the role of political persuasion. In these parts, Schumpeterian themes are addressed. But eschewing Schumpeterian notions of irrationality and leadership, Downs tries to vindicate his model in rather inconclusive ways.

An interesting case is Downs‘ finding that in two-party systems it is rational for both parties „to be as equivocal as possible about their stands on each controversial issue (*ibid.*, 136). As a result, voters may be

„encouraged to make their decisions on some basis other than the issues, i.e., on the personalities of candidates, traditional family voting patterns, loyalty to past heroes etc. But only the parties‘ decisions on issues are relevant to voters‘ utility incomes from government, so making decisions on any other basis is irrational“ (*ibid.*, 137).

But for Downs only „(a)pparently the more rational political parties are the less rational voters must be, and vice versa“ (*ibid.*, 137). He offers rather eclectic „defences against

being forced into irrationality“ (ibid., 138f), such as legal limits on parties‘ exploitative power, a change to multiparty systems, the desire to preserve democracy or, very reluctantly, the concession that voting may be „less than perfectly rational as a mechanism for selecting governments“.

When it comes to the „leadership“ issue, persuasion is only allowed by providing correct information, not by shaping preferences or providing false information (ibid., 84). Political entrepreneurs are first of all followers, „for they mould their policies to suit voters so as to gain as many votes as possible. Having done this, they attempt to lead all voters to believe these policies are best for them“ (ibid., 88). Also new parties yield precedence to the given voter distribution: they only enter *after* voters kindly make room for them in the political space (ibid., 125). Downs‘ political men in power don‘t create political “markets” and followers, they aim to please instead to lead.

Hence, even where Downs points at Schumpeterian themes he finally retreats to the safe grounds of instrumental rationality and spatial voting logic. Most of his followers also refrained from exploring these wild territories. The pure logic of voting created enough logical puzzles and mathematical curiosities (such as cycling) to keep Public Choice scholars busy working out technical details and variations. In the same way as the logical consistency and theoretical possibility of the bloodless construct of perfect competition fascinated economists more than the question how prices or goods are actually created in the market process, the question how voter positions and issues emerge has been dominated by problems of proving the possibility of stable and unique spatial equilibria in an aseptic world (Rowley 1984, 105). Schumpeter’s (1942/87, 77) early critique of the former may also be applied to the latter: “in the process of being more correctly stated and proved, the proposition lost much of its content – it does emerge from the operation, to be sure, but it emerges emaciated, barely alive”.

To be sure, spatial voting models can be very useful. Even the simplistic median voter model may provide empirically meaningful explanations for outcomes of direct-democratic elections with one-dimensional, ordinally scaleable issues or with two parties competing mainly in terms of one easily accessible and quantifiable issue such as tax policy. It is no accident that empirical tests of the median voter model (e.g. Holcombe 1980, Munley 1984) mostly look at referenda in which the issue space is, indeed, one-

dimensional and given, and in which the median income recipient may serve as a proxy for the median voter (e.g. Inman 1978; Pommerehne 1978). But in his survey Mueller (1989a, 193) concludes that the empirical evidence is „hardly encouraging as to the potential for predicting the outcomes of representative government with a model that treats the median voter as if he were dictator“.

This is where Schumpeter drastically differs from demand-driven spatial voting models. For him, democracy is competition for leadership and not for given voter distributions. And even if median voter positions had nothing to do with utilitarian notions of the common good (or, for that matter, Paretian welfare conditions), one can argue with Schumpeter’s (1942/87, 253) that this “still leaves us with plenty of difficulties on our hands”. These difficulties deserve being quoted at length, since they also apply to some underlying characteristics of the spatial voting model:

“In particular, we still remain under the practical necessity of attributing to the will of the individual an independence and a rational quality that are altogether unrealistic. If we are to argue that the will of the citizens per se is a political factor entitled to respect, it must first exist. That is to say, it must be something more than an indeterminate bundle of vague impulses loosely playing about given slogans and mistaken impressions. Everyone would have to know definitely what he wants to stand for. This definite will would have to be implemented by the ability to observe and interpret correctly the facts that are directly accessible to everyone and to sift critically the information about the facts that are not. Finally, from that definite will and from these ascertained facts a clear and prompt conclusion as to particular issues would have to be derived according to the rules of logical inference – with so high a degree of general efficiency moreover that one man’s opinion could be held, without glaring absurdity, to be roughly as good as every other man’s. And all this the modal citizen would have to perform for himself and independently of pressure groups and propaganda, for volitions and inferences that are imposed upon the electorate obviously do not qualify for ultimate data of the democratic process.”

As will be shown in the next part, this sketch of a moderate classical doctrine’s underlying assumptions comes very close to what Downs (and most of his followers more implicitly) assume – and to what Schumpeter is not ready to accept. His assumption that that “modal citizens” have no independent, clear and definite position on political issues, no independent power to put issues on the political agenda and no adequate means to voice their opinion (if they have one) leads Schumpeter to infer the vital role of political leadership. It consists as much in shaping a “manufactured will” of the masses as in turning latent “group-wise volitions” into political factors (ibid., 270), thus *creating* voter distributions instead of just following them and creating “voice” instead of just listening to it.

In addition, political entrepreneurship is a managerial challenge. Political parties are not, as Downs (1957, 25f) defined them, “teams ... whose members agree on all their goals”. Treating “each party as though it were a single person” (ibid.) also eliminates party leadership which for Schumpeter is equally important. He (1942/87, 277) describes the political leader in a way some well-remembered (and re-elected) Prime Ministers or Presidents have in fact acted: they “lead party opinion creatively – shape it – and eventually rise toward a formative leadership of public opinion beyond the lines of party, toward national leadership that may to some extent become independent of mere party opinion”.

The reader might endorse my claim that political leadership is essential in Schumpeter’s theory of democracy, whereas in spatial voting models it is not. But one may still doubt if Schumpeter’s description of the typical citizen is categorically different from the representative citizen as modelled in most of Public Choice. Has not Public Choice (following Downs) shown that rational voters are, for good reasons, vastly uninformed about political programmes and issues? It has. But that does not make it Schumpeterian. I leave aside the internal tension that “rational ignorance” creates within the median voter logic. Suffice to mention that now the model implies that competing candidates are driven to take exactly the position of a (median) voter who herself does not know where she stands and what she wants! Instead, I want to show that rational ignorance, as presented by Downs (1957) and dominantly used by Public Choice is logically flawed in itself and based on clearly un-Schumpeterian arguments.

### **3.2 “irrational impulse” vs. “rational ignorance”**

Throughout Downs’ thesis (including his discussion of „rational ignorance“) and in spatial voting models quite generally, party differentials are „the most important part of a voter’s decision“ (Downs 1957, 40). Downs defines the party differential as „the difference between the utility income he actually received in period t and the one he would have received if the opposition had been in power“ (ibid.) – a rather demanding calculation to start with.<sup>6</sup> But that is not all. In addition, the rational voter amends her current party differential with two future-oriented modifiers: a „trend factor“ (to account

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<sup>6</sup> Modern versions apply various assumptions such as prospective or retrospective, deterministic or probabilistic voting. The demands on voters’ rational calculation capacities, however, do not vary much.

for recently improving or degenerating performances of the parties) and another performance rating – in case the current party differential is zero (ibid., 41f). In multiparty-systems, she is also „predicting how other citizens will vote by estimating their preferences“ (ibid., 48) since she has to know if her preferred party has a chance to end up in the winning coalition. Furthermore, she must balance each party’s net position (the mean of its policies) against its spread (their variance) within the issue space („In short, voters choose policy vectors rather than policy scalars, and each vector is really a frequency distribution of policies on the left-right scale“ (ibid., 133).

Already these calculations (omitting further variables<sup>7</sup>) seem more demanding (and less entertaining) than those necessary for enjoying (and occasionally succeeding in) a game of bridge. This is said in order to restate Schumpeter’s (1942/87, 261) claim that

„when we move ... into those regions of national and international affairs that lack a direct and unmistakable link with ... private concerns, individual volition, command of facts and method of inference soon cease to fulfil the requirements of the classical doctrine ... the private citizen musing over national affairs ... is a member of an unworkable committee, the committee of the whole nation, and this is why he expends less disciplined effort on mastering a political problem than he expends on a game of bridge“.

Downsian “rational ignorance” does not build on this simple consideration, but on the voter’s calculation of his party-differential which is “the basic return upon which subsequent calculations are built” (Downs 1957, 272). The latter also include the voter’s calculations of the optimal amount of ignorance he decides to leave rationally unhealed, carefully procuring political information only if its expected pay-off exceeds its cost (ibid., 272). From a history of ideas perspective, it is noteworthy that Downs anticipated much of what Stigler (1961) or Arrow (1962/85) later introduced as the economics of information. But thanks to Downs’ frank verbal exposition, fundamental problems of subjecting individual ignorance to marginalistic calculations are more accessible here than in more modern variants.

"Three factors determine the size of his planned information investment. The first is the value of making a correct decision as opposed to an incorrect one, i.e. the variation in utility incomes associated with the possible outcomes of his decision. The second is the relevance of the information to whatever decision is being made. Is acquisition of this particular bit of knowledge likely to influence the decision one way or another? If so, how likely? ... This probability is then applied to the value of making the right choice (the vote value in our example), From this emerges the return from the bit of information being considered, i.e., the marginal return from investment

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<sup>7</sup> The full calculation process would also include variables such as „long-run participation values“, „the cost of voting“ and „preference for change“. For a full rendition of the logic see Downs (1957, 271f).

in data on this particular margin. The third factor is the cost of data. The marginal cost of any bit of information consists of the returns foregone in obtaining it. A comparison of the estimated marginal cost and estimated return of any bit determines whether this particular bit should be acquired” (Downs 1957, 215f).

These calculations of “the quantity of information it is rational to acquire” (ibid., 214) show that most properties of the investment good “information” are already known and hence: that the investment must already have been made. This is already true for the first factor: How is a voter to know the value of making the right decision if he does not already know future “utility incomes” created by the parties in question? He seems to already have the relevant information (before he “acquires” it). The paradox becomes even more glaring with the second factor: How is the voter to determine if and how much a bit of information will be influencing her decision, if she does not already know its content? The problem of marginal optimisation of rational ignorance is more than just marginal. The problem is that the “worth of new knowledge cannot begin to be assessed until we have it. By then it is too late to decide how much to spend on breaching the walls to encourage its arrival” (Shackle 1972, 272f).

Even the calculation of the third factor shows that Downs’ knowledge-seeking citizen already knows what he cannot know before he invests in knowledge. As the opportunity costs of investing in political information Downs dominantly uses “the time used for assimilating data and weighing alternatives” (ibid., 209) – which remains a relevant cost-factor for free political information. But also the returns foregone by spending time investing in political information are by no ways known *ex ante* (if they can ever be known at all, see Buchanan 1969).

The very concept of rational ignorance based on the equalisation of marginal costs and benefits of investments in new knowledge is, therefore, no serious qualification of perfect rationality assumptions. It is rather their elevation to logically absurd levels of “super-optimization” (Knudsen 1993, 143) or the omniscient determination of ignorance. Such naïve information economics can at best yield “as-if” heuristics of the simple fact that with subjectively expected rising benefits of more information, more information is demanded, and with subjectively expected greater benefits of alternative uses of scarce resources, investment in information is reduced. But there is no way to rationally optimise one’s ignorance, since no one knows what he misses by not investing in new knowledge.

As in other instances, Downs (1957) is well aware of some inner tensions facing his rationalistic framework<sup>8</sup>, which leads him to develop interesting amendments to the basic logic in order to rescue the model. This time, he retreats to probabilistic calculations building on “subjective estimates based on whatever information he has already acquired” (ibid., 242). Our voter may already have estimated his party differential at 50 utility units (the “estimated cost of being wrong ... upon which subsequent calculations are built”, ibid., 241) and is now “confronted” by a single bit of information (ibid.). “All a voter really knows about each bit before [!] acquiring it is (1) a list of its possible values, (2) the probability associated with each value, and (3) its cost.” Thus, in Downs’ numerical example, the voter knows in advance that he will have to sacrifice 10 units (utility forgone by not spending time or money on other uses). Now, he expects with probability 0.5 that knowing the content of the information would increase his party differential by 100 units, with probability 0.4 it will decrease it by 10 units and with probability 0.1 it will decrease it by 100 units. The expected value of knowing more is thus 36 units of enlarged party differential. Which, as such, would make the information valueless for his voting decision, since he would not have voted differently had he spent his time (or money) on something else (ibid.).

The reason is that Downs’ “rational voter is interested only in information which might change his preliminary voting decision ... only this information provides returns in terms of a better decision or increased confidence in the present one” (ibid., 241). This follows indeed from pure instrumental logic; but it fundamentally contradicts psychological intuition and empirical observation.<sup>9</sup> But the story goes on. The rational voter is not guided by the overall expected value of the information he is about to acquire; rationally he consults the entire distribution of each bit before he decides. And since there was a 0.1 chance that it will shift his position to favouring the other party by 50 units, he buys it in order to avoid a loss of 40 units (after deducing the 10 units for acquiring it)!

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<sup>8</sup> Downs (ibid., 241) notes that there is an infinite regress problem when starting with a party differential before investing in information. He cuts it short by assuming that there is a „preliminary estimate“ of the party differential „derived without serious consideration of the cost and returns of making the estimate“.

<sup>9</sup> As will be shown in more detail in part 5.1, psychological and empirical research both strongly indicate that people’s attitudes in selecting (sources of) information and opinion are fundamentally verificationist. Especially in politics, where such behaviour is „cheap“, it can loom large. But it has no place in Downs’ world of pure instrumental rationality. Here, people are even advised to consult newspapers that are most likely to provide information that contradicts their ideological views (Downs (1957, 214)).

Downs' example not only illustrates the above-mentioned information paradox in even more lustrous detail. It also shows just how far the rational ignorance model ignores "the chapter of social psychology which might be entitled Human Nature in Politics" (Schumpeter 1942/87, 256).<sup>10</sup> In fact, Downs' (1957, 7) initial claim that "our homo politicus is the 'average man' in the electorate ... he will not be as much of a calculating-machine-brained character as was the utilitarians' economic man" is nowhere contradicted more clearly than in Downs' treatment of "rational ignorance".

Only after having elaborated all details of the above logic of rational ignorance, Downs introduces the complication that party differentials will have to be discounted to account for the fact that a single vote has minimal impact on outcomes. Now the rational voter has to start his calculations with the "vote value" which "is compounded from his estimates of his party differential and of the probability that his vote will be decisive" (ibid., 244). Had Downs introduced the simple fact of a single voter's impotence earlier most of his rational voting calculus would have been redundant, which from the beginning was oriented only towards selecting a government which yields the highest personal utility income. Downs' categorical instrumentalism was introduced on page 7: „The political function of elections in a democracy, we assume, is to select a government. Therefore rational behavior in connection with elections is behavior oriented toward this goal and no other“ (s.a. ibid., 136, 145). It breaks down on page 245, when we learn:

“A rational man may buy information because (1) he wishes to influence the government's policies, (2) his prediction of how other voters will act indicates that the probability is relatively high that his own vote will be decisive, or (3) he derives entertainment value or social prestige from such data” (ibid., 245).

As a consequence, voters in any large-scale elections which a theory of democracy should reasonably address, buy information either because they are ignorant of the fact that millions of other voters upset their instrumental purpose, or because they strive for aims which were so far labelled "irrational", since they are not related to the social function of democracy! Similar reasoning applies to Downs' chapter on rational abstention (ibid., 260ff). Again, instrumental rationality solely aimed at selecting the "right" party which

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<sup>10</sup> Another consequence is that the more indifferent voters are (starting with low initial party differentials), the more willing they should be to invest in political information, whereas partisan voters would be most rationally ignorant, since it takes much more costly adverse information to change their minds - which remains the only rational reason for them to acquire it (ibid., 243). This inference is the exact opposite to empirical research in public opinion formation, as presented with overwhelming evidence, e.g., in Zaller's (1992) studies on "The Nature and Origins of Mass Opinion".

yields the highest utility income does not suffice (once reasonably discounted for the fact of large numbers) to give “reason” to vote as soon as costs are involved. And again, factors previously discarded as “irrational” have to do the job.

Here Downs comes dangerously close to introducing “classical” motives, e.g. when he argues that “(i)t is sometimes rational for a citizen to vote even when his short-run costs exceed his short-run returns, because social responsibility produces a long-run return” (ibid., 261). Even mainstream Public Choice, after considering the free-rider problems, found it hard to follow Downs in rationalising voting as a contribution to the public good called “making democracy possible” (ibid.). Instead, one was forced to refer to one of the two alternative explanations: (a) intrinsic or extrinsic benefits derived from being (known to be) a voter who performs her civil duty (“ethical voter hypothesis”, e.g. Riker and Ordeshook 1968, Pennock 1989, 26f) or (b) satisfaction of being able to simply express one’s opinions (“expressive voter hypothesis”, e.g. Brennan and Buchanan 1984, Brennan and Hamlin 2000). Both hypotheses entail “irrational” voter behaviour if Downs’ yardstick of instrumental rationality holds; they claim that “neither the act of voting nor the direction of the vote can be explained as a means to achieving a particular political outcome” (Brennan and Buchanan 1984, 187).

### **3.3 back to Schumpeter? - consequences for Public Choice**

The consequences – not only for Downs’ reasoning, but for Public Choice at large – are rather uncomfortable. Voters are both “rationally ignorant” and “rationally absent” if rationality is aimed at achieving maximum utility incomes from electing political alternatives. But obviously, citizens do have some (if poor) information about politics, they hold political opinions and many, often most, of them vote. Either these voters are effectively irrational (lured in the absurd belief that an individual voting decision affects outcomes) or they vote and have political opinions for better reasons than those derived from Downsian instrumental rationality. These better reasons could be entertainment value, social prestige or even moral convictions.<sup>11</sup> Adding elements of “mass behaviour”, “impulse” and “affection”, we would, after a long and tiresome detour with calculations of “party differentials” and “vote values” be back at the Schumpeterian vantage point.

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<sup>11</sup> Downs himself more recently criticised Public Choice for treating individual preferences and values as given, individual motivations as solely selfish and restrictions as solely external to the individual. He now stresses the functional qualities of shared moral values and informal conventions (see Downs 1991).

And we might indeed have found strong reasons to substitute a chapter on “Human Nature in Politics” for the voter as homo oeconomicus.

The same reasons can lead us to make more allowances for Schumpeter’s stress on the vital fact of political leadership. If voters do not position themselves on the drill grounds of given issue spaces after having gone through painstaking calculations of party differentials – if they are indeed driven by such malleable forces as entertainment value, social prestige or perceived demands of social duty – political leaders have much more leeway in pushing through their own agendas and creating their own electorate.

Along both lines Public Choice may find its way back to Schumpeter; or rather: may be challenged to take up his issues of bounded rationality and political leadership and integrate them in a more advanced theory of the political process.

#### **4. Schumpeterian Political Economy: still another theory of democracy**

*„If ... the straightjacket of neoclassical public choice is left behind and a more open view of political economy is adopted, it becomes clear that Schumpeter’s writings still have very much to offer“* Bruno S. Frey 1981, 140.

Parts of Public Choice have already embarked on this journey towards a more Schumpeterian political economy: (1) Non-homo-oeconomicus determinants of voter behaviour have been endorsed by economists who accept bounded rationality (rather than super-optimising rational ignorance), “sociological” forces (rather than independently determined reasons to act) and even “moral dimensions” as relevant for voting behaviour under the special conditions of low-cost decisions.<sup>12</sup> (2) Non-adoptive behaviour of political entrepreneurs has also been recognised by a number of Public Choice scholars who discuss the art of political manipulation, opinion leadership, decision framing, political innovation and reform and other aspects of supply-side political activity.<sup>13</sup>

But the more general models of electoral competition still remain very much in the Downsian tradition of analysing voters as rational calculators of party differentials and parties as passive brokers of given (median) voter preferences in a given issue space. In addition, there has been a remarkable renaissance of rationalism, tight prior equilibrium

<sup>12</sup> E.g. Frank (1988), Brennan/Lomasky (1989), Kirchgäsner/Pommerehne (1993), Brennan/Hamlin (2000).

<sup>13</sup> E.g. Frohlich/Oppenheimer (1978), McLean (1987), Buchanan/Vanberg (1989), Dunleavy (1991), Williamson/Haggard (1994), Johnson/Libecap (1999), Wohlgemuth (2000), Arce M (2001), Sheingate (2001).

and political efficiency which defies any “sociological”, “psychological” (or, for that matter: Schumpeterian) explanations: the new Chicago Political Economy (e.g. Wittman 1995). This paper focuses on two areas of research in which Public Choice is leaving behind the straightjacket of neoclassical pure logic of choice and in which a theory of democracy could be developed in a more or less Schumpeterian spirit: (1) bounded political rationality and (2) political opinion formation.

#### **4.1 Towards a (cognitive) economics of bounded political rationality**

Downs (1957, 6) explicitly used a “narrow concept of rationality”. Its narrowness lies not so much in his definition of rationality of conduct, but of connecting it with a rationality of ends. The first entails standard assumptions drawn from Arrow (1951) such as the individual’s ability to rank all alternatives in an ordinal and transitive way, to always chose the alternative that ranks highest, and to always make the same decision when confronted with the same alternatives (ibid.). The second element claims that “rational behavior in connection with elections is behavior oriented towards this end (the selection of a government) and no other” (ibid., 7). Downs insists on end-oriented, instrumental rationality, which leads politicians to select policies which procure the highest voting share, and voters to select politicians which procure the highest utility income.

As Downs himself has more or less inadvertently shown towards the end of his study, rationality of behaviour and his idea of rationality of ends may well be in conflict. In the face of voters’ impotence or indifference, party differentials can hardly be assumed to take the form of elaborated preference rankings which would dominate other (even less scaleable) elements of voting behaviour. And even if party differentials were still assumed to dominate, rational calculations on their basis make no (rational) sense as soon as opportunity costs are involved. Theoretical and empirical research meanwhile provides ample material for questioning political rationality on both fronts: the instrumentality of voter behaviour and the rationality of behaviour as such.

##### **non-instrumentalistic elements in voting behaviour**

I have argued that the very decision to vote must be primarily motivated by a sense of duty or by pleasure derived from the (inconsequential) expression of one’s political preferences. Voting cannot reasonably be regarded an instrumental act aimed at choosing

higher “utility incomes”. It is the act of voting as such that may yield benefits in terms of self-respect or respect of others – both at very low costs.

Similar reasons hold for the decision to invest in political information. With large numbers of the electorate, there is no instrumental link between a better informed vote and higher returns of “making the right decision” in Downsian terms of party-differentials. Again, reasons must be found outside the “basic logic of voting” (Hardin 1999, 8). One reason may be the entertainment value of political news, scandals and opinions. Another reason may be the reputational value of being regarded a good entertainer or a knowledgeable person. Hirschman (1989) presents good reasons for having opinions as elements of individual well-being: „not to have an opinion is tantamount to not having individuality, identity, character, self“ (ibid., 75), and: „vacillation, indifference, or weakly held opinions have long met with utmost contempt, while approval and admiration have been bestowed on firmness, fullness and articulateness of opinion“ (ibid., 76).

But if individuals mainly strive for reputational utility in the sense of Kuran (1995)<sup>14</sup>, they are even “more dependent on society in political contexts than in the realm of ordinary consumption” (ibid., 162). This dependence, in turn, begs recognition that political opinions rest to a large extent “on beliefs shaped by *public discourse*, which consists of the suppositions, facts, arguments, and the theories that are communicated publicly” (ibid., 18). As will be shown in 4.2, it is exactly under these premises that the meaning of democracy as an opinion forming process can be established, in which political entrepreneurship has an important role.

Different reasons *why* political opinions are formed and expressed also explain *how* citizens become informed – again differing sharply from Downs’ assumptions of instrumental rationality. Remember that Downs’ “rational voter is interested only in

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<sup>14</sup> Kuran (1995, 24ff) distinguishes 3 kinds of utility an individual can derive from publicly expressing an opinion: „intrinsic utility“ to be gained in terms of private benefits of collective decisions, „reputational utility“ derived from the social approval of others (which, if dominant, creates „preference falsification“, see below) and „expressive utility“ based on an individual’s self-respect and self-assertion (which counteracts „preference falsification“). While these utilities make a difference in *what* opinions are publicly articulated, they all provide reasons *that* political opinions are in fact entertained. As Kuran (ibid., 41) notes, standard economics tends to regard intrinsic utility as the sole driving force of individual action. Reputational and expressive utilities are rarely integrated in the rational choice model. Which is fatal for the economic analysis of voter behaviour, as only these kinds of benefits are in fact attainable!

information which might change his preliminary voting decision” (1957, 241); information that confirms his established view has no instrumental value. But after discounting the instrumental value of political information to next to zero, a substantially different (and much more realistic) behavioural pattern emerges. This pattern can be built around (a combination of) psychological and economic-sociological theories. As an example of the first category, the theory of “cognitive dissonance” suggests itself, which was developed by Festinger (1957) and interpreted for economists by Akerlof/Dickens (1982). The latter summarise the results of cognitive-psychological research:

„First, persons not only have preferences over states of the world, but also over their beliefs about the state of the world. Second, persons have some control over their beliefs ... they can also manipulate their own beliefs by selecting sources of information likely to confirm ‘desired’ beliefs. Third, ... beliefs once chosen persist over time“ (ibid., 307).

Applications of these propositions to a theory of political behaviour should prove most promising for a Schumpeterian theory of democracy in which the manipulation of beliefs would be a prominent feature (Brady/Clark/Davis 1995). Whereas Schumpeter stressed the fact that voter-citizens are objects to manipulation by political leaders, the (conscious or unconscious) attempts of individuals to “manipulate” *themselves* by selecting confirming and comforting information also deserves recognition in a “chapter of social psychology”. Selective perception and storage of information in accordance with established preconceptions or perception-filters is a pattern persistently found by psychological research (Rosenberg 1991, Rabin 1998). As Kuran (1995, 173) summarises: “our beliefs govern what we notice in the first place. We perceive selectively, noticing facts consistent with our beliefs more readily. This bias imparts resistance to our beliefs by shielding them from counterevidence”.

The desire to verify and not falsify one’s preconceived opinions is not only “all-too-human” in general, it is also “all-too-cheap” in politics. Ignoring alternative information and opinions and thus being led into self-assuring delusions must be expected to be particularly pronounced in areas of “cheap talk” instead of consequential individual decisions (Kirchgässner/Pommerehne 1993, Caplan 2001). While such behaviour would be costly on the economic marketplace, on the “marketplace of ideas” it is not. It may even be rather rewarding since it reduces the “psychological costs” of dissonance (Weissberg 1996, 113) and the “reputational costs” of disagreement (Kuran 1995).

The fact that political knowledge for most citizens is not so much an instrument to attain private returns from voting but to secure personal comfort and social approval, creates self-reinforcing and self-justifying tendencies of public opinion formation. Citizens exchange opinions and political information most likely with people who already share their political preferences (Huckfeldt/Sprague 1995). And they tend to *express* opinions which they expect to be generally accepted within the group in which they find themselves – even if they may hold different opinions as their inner secret (“preference falsification”, Kuran 1995, see also 4.2).

Finally, it should come as no surprise that serious deviations from Downsian instrumental rationality are also found in empirical analyses of the voting decision itself. If already the participation at elections, the information selected, and the opinions expressed before the election were based on such elements as social demands, moral impulse or the aim to please, the decision what to vote for should not be motivated much differently. To be sure, the cunning voter may, in the anonymity of the voting booth, “vote his pocket book” or party differential, even if in public she may pretend to be driven by more socially rewarding motives. But even this cleverness would be inconsistent. It may cause more inner strain than pleasure to live a political Jekyll-and-Hyde life; and it will certainly fail to produce different political results. If the individual vote makes no difference, voting for the most respected party in one’s group of peers, or voting for the most likely winner does no harm. And if it produces any good feelings (be that “inner peace” or “outer peace”), such emotions should dominate the instrumental “voting in my private interest” as prescribed by the *homo oeconomicus* model.

These considerations find support in empirical studies (see Udehn 1996, 78ff; Nannestad/Paldam 1994, 223ff; Mueller 1989a, 367ff for overviews). In referenda, expenditures that benefit specific groups are also supported by members of groups who know that they would have to pay the bill; voters are more responsive to general economic conditions than to their personal economic situation (“sociotropic voting”, Kinder/Kriewiet 1981). In addition, many voters seem to be more strongly affected by “symbolic politics”, traditional voting patterns, ideologies, moral convictions and socialisation than by regards to their economic self-interest (Sears/Lau/Tyler/Allen 1980). A strong support for the influence of communication communities (neighbourhoods, families, churches) is also found in many studies (Butler/Stokes 1974, Huckfeldt/Sprague 1995).

It remains problematic to interpret this evidence. An “ethical voter interpretation” could produce, by non-Downsian means, a rather Downsian result. In terms of modern contractarianism it can be argued that the factual “veil of insignificance” (Kliemt 1986) of voter behaviour achieves much of what a hypothetical “veil of ignorance” might be able to produce. The latter presupposes that citizens not knowing their social position in a future society will vote for generally fair rules (since they might apply to themselves). The former may work even if people know what their personal interests are; but the insignificance of their personal vote would make them more inclined to vote for a “common good”. As a consequence, Public Choice may once again come dangerously near to the basic presumptions of the classical doctrine (see Mueller 1989b, 86).

Another interpretation, however, arrives at a very different valuation of the same facts. Much in a Schumpeterian spirit, Brennan/Lomasky (1989) argue that voters can afford to indulge in most short-sighted, irresponsible, ideological expressions of romantic or malicious ideas. In the aggregate they may take most costly decisions, but the individual voter faces no costs as consequences of her single decision. An anonymous voter can act in ways she would never dare to take if she were accountable for her decisions. Schumpeter (1942/87, 262) makes the same point when he expects that the voter, due to „the absence of effective logical control over the results he arrives at ... will relax his usual moral standards ... and occasionally give in to dark urges which the conditions in private life help him to repress“. But „it will be just as bad if he gives in to a burst of generous indignation“, since this „will make it still more difficult for him to see things in their correct proportions or even see more than one aspect of one thing at a time“ (ibid.)

Already at this stage – without having to introduce “policy failure” arguments from rent-seeking or bureaucracy theory – Brennan/Lomasky (1989) arrive at a strong denial of the democratic processes’ rationality. As a consequence of high arbitrariness of voting motivations, “what emerges through democratic procedures may not be the will of the majority, and may not have been desired by a single voter” (ibid., 44). Thus having effectively destroyed *instrumental* rationality of both voter behaviour and the democratic process, Brennan/Lomasky still maintain that voters are at least “not predominantly irrational” – even if “they vote as they do for reasons that have little to do with an intention to affect outcomes”. Others, such as Caplan (2001) or Akerlof (1989) argue that

individual irrationality, illusions and systematically biased beliefs are just what an economic opportunity cost reasoning would lead one to expect, since democracy sets the private cost of socially costly irrationality at zero. I will now take a look at the rationality issue as such.

### **Non-rationalistic elements in voting behaviour**

Usually economists do not, as Downs did, extend their concept of rationality beyond the realm of means applied to achieve whatever ends. Individual ends pursued can be of any kind; *de gustibus non est disputandum*. But it is assumed that these ends (whatever they may be) are pursued rationally, i.e. by choosing those alternatives which rank highest on a given preference scale and can be achieved under given constraints of scarce resources. This limitation of the rationality postulate is very reasonable in itself, since it avoids making presumptuous or paternalistic judgements about people's aims and values. However, it also brings the analysis closer to truistic statements: if any end is allowed, it is hard to identify means that are not "rationally chosen" in view of these ends as long as the latter are not known or at least postulated.<sup>15</sup>

I will not go deeper into these methodological matters. Instead, I want to show that even if rationality is bound to a choice of means for achieving a wider range of ends, this does not create bounded rationality. Anomalies and "irrationalities" remain even if one drops the determination of rational ends. Cognitive science and experimental psychology meanwhile substantiated much of what Schumpeter took for granted when he, e.g., suspected that the voter's "power of observation and interpretation of facts, and his ability to draw, clearly and promptly, rational inferences" are very limited, that his "thinking becomes associative and affective" and would "tend to yield to extrarational or irrational prejudice and impulse" (1942/87, 256 and 262). I cannot here discuss the manifold details of the experimental evidence and their often controversial interpretations.<sup>16</sup> But the overall evidence contradicting Bayesian (or for that matter Arrowian and Downsian)

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<sup>15</sup> This is exactly Downs' position: „Even though we cannot decide whether a decision-maker's ends are rational, we must know what they are before we can decide what behavior is rational for him. Furthermore, in designing these ends we must avoid the tautological conclusion that every man's behavior is always rational because (1) it is aimed at some end and (2) its returns must have outweighed its costs in his eyes or he would not have undertaken it“ (1957, 6).

<sup>16</sup> See Tversky/Kahnemann (1987), Kahnemann/Tversky (1984), Quattrone/Tversky (1988), Frey/Eichenberger (1991), Wahlke (1991), Rosenberg (1991), Thaler (1987), Lau/Sears (eds., 1986).

standards of rational behaviour and learning is impressive.

Much of the evidence can be explained in terms of Simon's model of bounded rationality. Due to limited cognitive capacities of the mind, individuals rely on rather simple behavioural heuristics and "rules of thumb" which generally "satisfice" learned levels of aspiration, instead of engaging in case-by-case optimisation based on a comprehensive consultation of data and alternative modes of behaviour (Simon 1957; 1978; 1986)<sup>17</sup>. More striking evidence of decision anomalies, biases and mistakes may be explained by "prospect theory" (Kahnemann/Tversky 1984) which claims, among other things, that individuals choose schemata of arranging the outside world which at the moment are most available rather than most "rational", "objective" or "effective". Such conditions can be exploited by others who manipulate individual decisions by ways of "framing" the context of a decision and thus producing biased results in the framers' interest (see Quattrone/Tversky 1988).

It has rightly been argued that one has to be careful in drawing inferences from observing anonymous decisions of isolated individuals playing experimental games in which errors are costless (e.g. Wittman 1995, 41; Smith 1985). Such objections carry much weight when, e.g., financial investment decisions are put to laymen in experiments that fail to recreate elementary characteristics of such markets – such as the monetary stakes, the professional division of labour, or competitive pressures which help avoid or creatively destroy at least some anomalies (e.g. Thaler 1987). But peculiarities of *voter* decisions are very well reproduced by experiments with costless errors, anonymous decisions, lack of competitive selection and of a division of labour which would allocate property rights (voting rights) to those who are more specialised, experienced and knowledgeable and who may thus be less vulnerable to anomalous behaviour.

This is exactly what Schumpeter would have expected, who links weaker mental performance with weaker incentives and weaker market forces. Also the "framing" issue is, of course, just another way to express the major element of Schumpeter's theory of democracy which links "the weaker ... logical element in the process of the public mind

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<sup>17</sup> Different models of „bounded“, „procedural“ or „rule-following“ rationality have been proposed which share most of Simon's basic assertions. See, e.g. Hayek (1968/78), Fiske/Taylor (1984), Selten (1990), Vanberg (1993) or Denzau/North (1994).

...” with greater “... opportunities for groups with an ax to grind” (1942/87, 263). These groups of political entrepreneurs “are able to fashion, and, within very wide limits, even to create the will of the people” (ibid.). In modern language: if individuals in situations such as those produced by experiments and general elections are susceptible to anomalies, framing and manipulations of contexts, there will be political (mis-) leaders who know the “art of manipulation” (Riker 1986) and use it.

But not all political leadership needs to be manipulative. Much of it will be formative in rather innocent ways. An important case where political “leadership” and “framing” in a neutral meaning are active and, in fact, indispensable, is the formation of public opinion.

## **4.2 Towards an (Austrian) economics of political opinion formation**

„Public opinion“ is a non-issue in Public Choice theory. There are good reasons for this. Public opinion is one of the “most controversial, ambiguous, and nontransparent concepts in the social sciences” (Splichal 1999, 1). To make things worse, what most definitions of public opinion do, after all, have in common, contradicts the Downsian or spatial politics perspective more than once: Public opinion is exactly *not* (1) an additive aggregation of (2) isolated individuals’ given preferences on (3) given issues. I now present these elements of public opinion in order to highlight some aspects which would be essential for a Schumpeterian theory of democracy, but cannot be dealt with in a spatial politics framework (see Wohlgemuth 2002a and 2002b for more comprehensive accounts).

### **qualitative and cognitive components of public opinion**

Private opinions are more than the private preferences which usually serve as data of economic equilibrium models. As Vanberg/Buchanan (1989, 50) point out, preferences consist of a combination of evaluative and cognitive components. They depend on interests in results (what one wants) as well as on theories about the effects of certain actions (what one expects). The combination of idiosyncratic, subjective penchants and interests (evaluative component) with equally subjective, but fallible and possibly erroneous conceptions, expectations or theories (cognitive component), describes economic as well as political preferences.

In some respects, political preferences rely even more strongly on cognitive components. Preferences for daily consumption-goods can mostly be a matter of taste, thus being unreflective and not affording any justification (*de gustibus ...*). The formation of political preferences, however, cannot dispense with „speculative or explanatory views which people have formed about ... society or the economic system, capitalism or imperialism, and other such collective entities, which the social scientist must regard as no more than provisional theories“ (Hayek 1952/79, 64). The citizen who wishes to express an opinion does this with reference to some conjectures about cause and effect (however inappropriate they are in the eyes of „expert“ observers).

In other words, the “value image” or the „ordering on the scale of better or worse“ of given alternatives (Boulding 1965, 47), which in most of economics of politics exclusively motivates political actors, is only a part of the image that guides human action. And it is not a part that can be properly isolated from other aspects of the image, such as, most of all, the „relational image“ (i.e. the subjective hypotheses on causal systems and regularities in the outside world, *ibid*, 48). This is most important when the static view of democracy as an aggregation of given preferences or pure value orderings is abandoned in favour of a dynamic view of democracy as a process that helps create and change opinions or value images combined with relational images.<sup>18</sup>

Even after combining individual preferences, interests or tastes with hypotheses, theories and (mis-) conceptions to private opinions, public opinion is not their mere aggregation. As already Lowell (1913, ch. I) pointed out in his classical treatment, the impact of individual opinions on public opinion depends on qualitative rather than quantitative criteria. Whereas in elections votes are counted but not weighed, contributions to public opinion also depend on the intensity with which preferences are felt, the verve with which they are expressed and the thrust with which the theoretical part of opinions is presented.

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<sup>18</sup> See Wohlgemuth (2002b) for a more detailed discussion of the differences between these two concepts of democracy. One defines democracy as a „procedure for passing from a set of known individual tastes to a pattern of social decision making“ (Arrow 1951, 2), the other as „a process of forming opinion“ (Hayek 1960, 108). In the Arrowian (or Downsian) understanding democracy is a mechanism to aggregate given preferences in a given issue space; and its task is to guarantee the logically consistent rule of a given will of the majority. In the Hayekian (or Popperian) understanding democracy is a process of the formation and discovery of changing opinions on changing issues; and its task is the replacement of incompetent leaders, the creation of knowledge, and the contestability of majority opinions.

Thus minorities can override less interested, less active, less convinced or less convincing majorities in the process of public opinion formation and articulation.

### **public opinion as a result of „opinion falsification“**

Kuran (1995) describes public opinion as the result of social interaction or, more precisely, social pressure. Public opinion is not the aggregation of private preferences, but the „distribution of public preferences“ (ibid., 17), that is, of publicly articulated views that can differ significantly from what individuals' preferences would be in the absence of social pressures. Most individuals appraise their opinion articulation by reference to their estimate of opinions held by those with whom they communicate. As a result, they engage in what Kuran calls „preference falsification“: preferences are opportunistically „falsified“ by those who carry their true preferences as their inner secret. This notion of “falsification” relates to „truth“ in the sense of their public *expression* being honest („true“) or dishonest (“false”).

But public discourse helps shape private preferences *and* private knowledge. And knowledge as embedded in human's “relational image” is subject to a different kind of falsification. Unlike values or tastes, theories about the world can be right or wrong. Individual experience and inter-subjective exchanges of arguments and evidence can lead to the „falsification“ of previously held views in the sense of learning about flaws or sheer errors of beliefs formerly held to be “true” or at least “satisfying”. A wider concept of “opinion falsification” (Wohlgemuth 2002b) embraces both: the disguise of true feelings (“preference falsification”) and the discovery of false beliefs (“theory falsification”). It is, therefore, the fear of social isolation and the longing for social prestige, but also the exposure of the embedded theories to falsification by arguments and experience that lets public opinion „rule“ within socially interacting groups.

To be sure, the claim that communication leads to the reconsideration of personal beliefs remains a far cry from Popperian ideals of falsificationalism. Especially when it comes to political opinions cognitive dissonance, selective perceptions and the innate tendency toward self-assuring delusions must be expected to be especially pronounced, since they form the background of “cheap talk” rather than individual decisions. But still, parts of the market-analogy can be applied to political opinion formation: When exchanging political opinions, citizens (and politicians) anticipate the social terms of trade and wish to „sell“ their view. This can induce them to (a) pick “buyers” who most probably support the same

basic views, (b) adjust their own views to those found in a given “market” of opinions or (c) improve the quality of their “product” by backing an opinion with more convincing evidence or logic. The fear of reputational losses, like a seller’s fear of pecuniary losses, urges individuals to constantly check which opinions and modes of behaviour are approved and which are disapproved of in their environment (Noelle-Neumann 1993, 37ff; Kuran 1995, 27). This, in turn, leads into self-reinforcing „frequency-dependency-effects“ as major propagation-mechanisms of public opinion (Witt 1996; Huckfeldt/ Sprague 1995).

Such theories about the inter-relatedness of private and public opinion may be an integral part of a “neo-Schumpeterian” economics of democracy. They may replace Le Bon’s “psychology of the crowds”, which Schumpeter (1942/87, 256ff) used to illustrate “Human Nature in Politics” – well aware of its “vulnerable points” such as its “narrowness of the factual basis” (ibid., 257). Instead, interactive processes of “image reformulation” (Boulding 1956) or “preference falsification” and the „hidden complexities of social evolution“ (Kuran 1995, ch. 17) triggered by these processes can be valuable contributions to a Schumpeterian agenda.<sup>19</sup>

A more obvious Schumpeterian contribution to a “public choice of public opinion” follows from a third difference to standard assumptions of Public Choice: political leadership.

### **political entrepreneurs and the creation of issues**

Just as goods (the objects of interactive price-formation) are not given in a market process, political issues (the objects of interactive opinion-formation) are not given in the political process. Issues have to be discovered or created and then pushed on the agenda. This activity entails costs and affords skills since the public’s attention is fundamentally scarce and ephemeral; it cannot deal with many issues at a time. Like competition on open markets, competition of ideas and opinions is driven by entrepreneurs.

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<sup>19</sup> These models would not only substantiate important shortcomings of political discourse compared to the articulation and satisfaction of private preferences on competitive *markets*. They can also help to formulate some modest virtues of democracy compared to other realistic methods of *political* decision making. After all, Schumpeter’s theory of democracy also seeks “to clarify the relation that subsists between democracy and individual freedom” (1942/87, 271). While Schumpeter (much like Hayek) claims no necessary relation between majority rule and personal liberties, he (again, like Hayek), acknowledges the value of the “freedom of discussion for all”, which quite naturally follows from the principle that “everyone is free to compete for political leadership” (ibid., 271f). Under these premises, it is possible to engage in comparative institutional analysis of political systems and argue in a rather Austrian spirit that democracy can be a “discovery procedure” of such knowledge and opinions as, without resort to it, may not be known or at least not be utilised (see Wohlgemuth 1999).

As Sunstein (1996) shows, many political movements owe the attention to their cause, often associated with a surprisingly strong and sudden change of attitudes of the general public to „norm entrepreneurs“ or opinion leaders who deliberately aim at inducing a swing in opinions and values. In Kuran’s theory, a similar role is attributed to „activists“ with „extraordinarily great expressive needs“ (Kuran 1995, 49) who dare formulate dissenting views and introduce new issues even in face of an apparently hostile or indifferent public. In Boulding’s (1956) chapter on the Sociology of Knowledge, changes in private and public images come about “through the impact on society of unusually creative, charismatic, or prophetic individuals” (ibid., 75) as “bearers of viable mutant images” – they are “the true entrepreneurs of society” (ibid., 76).

Political entrepreneurs take advantage of the fact that on many issues no strong and articulated opinions (preferences and theories) exist in the first place. The stock of views and knowledge about some issues is devaluated in the course of time and new problems arise, which cannot be assessed by recurring to established knowledge and ideological shortcuts. With the increasing complexity of political activities and environments the number of issues increases for which there is no public opinion ready at hand, no “issue space” exists and citizens have no idea where to position themselves. As a consequence, public opinion must become increasingly selective. The German sociologist Niklas Luhmann (1970/75, 16) concludes that the political system is more effectively shaped by attention rules than by decision-rules.

With Luhmann (ibid., 18f) one may describe the evolution of public opinions much in terms of product life cycles. An issue’s „career“ usually starts with a latent phase, during which only a chosen few affected by, or intrinsically interested in, a specific political problem know and discuss the issue. At that point it can not yet be assumed that politicians, media and least „the man on the street“ are willing or able to „take issue“. Some of the latent issues, however, succeed in attracting attention after political entrepreneurs (professional politicians or private agitators) have successfully invested in time, resources and personal contacts. With a bit of luck and skills these entrepreneurs achieve that the issue is taken up by larger “retailers” who are used to deal with changing issues in the process of transforming them into political demands and, at the end, into laws and regulations. At this stage the issue becomes part of „normal politics“: an “issue

space” is created; the media and citizens can take a position, discuss the issue, and expect that others are familiar with the major positions of the contending camps. Often, but not always, the discussion produces a generally accepted point of view, a public opinion that is characterised by a sufficiently large overlap of individuals’ images. Only now public opinion “rules” within large groups by means of fear of isolation, preference falsification and knowledge consolidation. And now is the time for adherents of the current common understanding to transform it into party platforms, laws, and regulations. If the issue does not reach this stage, it may well lose momentum and either disappear into oblivion or end up having only ceremonial value as an inconsequential expression of common sense.

Among the „issue entrepreneurs“ and “retailers” in this process parties, interest groups, and the media are the most prominent. And very much like their counterparts in capitalist society, they perform an entrepreneurial function, which is overcome the resistance of those who cherish “the routine tasks which everybody understands” (Schumpeter 1942/87, 132) by pushing through new issues on the limited agenda that public opinion is able to cope with. And, not unlike competition for consumers of most other goods, competition among “issue entrepreneurs” allows at best *temporary* „pioneer“ profits to be cashed in by creators of new issues. Profits from a monopoly of issue presentation and interpretation tend to disappear with the entry of other opinion makers. Thus, I argue, in the field of political leadership and issue entrepreneurship much of Schumpeter’s analysis of the capitalist process can also be applied to a more comprehensive analysis of competition for leadership.<sup>20</sup>

## 5. Outlook

*“Most of the creations of the intellect or fancy pass away for good after a time that varies between an after-dinner hour and a generation. Some, however, do not. They suffer eclipses but they come back again, and they come back not as unrecognizable elements of a cultural inheritance, but in their individual garb and with their personal scars which people may see and touch”* Schumpeter (1942/87, 3)

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<sup>20</sup> Another application along these lines would be to draw on Schumpeter’s discussion on “plausible capitalism” (ibid., ch. iv) and enter a similarly structured discussion of favourable conditions for “plausible democracy”. In Wohlgemuth (2000) I discuss two political “Schumpeter hypotheses” about relations between entry barriers in politics and the incentives and opportunities for political entrepreneurs to invest in long-term positive-sum reforms.

Mainly by ignoring the “vital fact of leadership” and by not accepting voters as “primitives” (Schumpeter 1942/87, 270 and 262), the modern economics of politics left both crucial elements of Schumpeter’s “other theory of democracy” largely unexplored. Especially today’s economics of political competition, which is still dominated by spatial voting models in the median voter tradition, can not claim to have Schumpeter as a precursor. To the contrary, we have even found occasions in which modern Public Choice, in terms of fundamental assumptions or of equilibrium results, looks strikingly similar to the classical doctrine against which Schumpeter’s whole thesis was directed.

Hence it is time to stop referring to a “Schumpeter-Downs theory of democracy” or celebrating of Schumpeter as a pioneer of today’s Public Choice. But is it time for today’s pioneers to start developing a neo-Schumpeterian political economy instead? A radical brake with Public Choice and a new start with an old book by Schumpeter would be a fatal enterprise – its costs being certainly high and its benefits highly uncertain. As Mitchell (1984, 77) argued:

“Whatever Schumpeter’s contributions to the study of politics, they assume the form not of positive theory in any strict sense, but a ‘vision’ ... a sort of ‘conceptual framework’ profusely illustrated by historical examples and emotively-inspired generalizations about humans ... Schumpeter did not set forth anything resembling a systematic, modern positivist theory of democracy”

This is not the best recommendation for academic entrepreneurs who set out to succeed in the present world of economics. But new combinations of modern (more or less “mainstream economic”) theories of democracy and some of Schumpeter’s visions and conceptual frameworks may be able to succeed and, in fact, to help Public Choice out of a sterility and stagnation which some critics are beginning to observe.<sup>21</sup>

Perhaps the most urgent and at the same time most difficult task for Public Choice still is to make sense of voter behaviour. Instrumental rationality based on calculations of “utility incomes” derived from “party differentials” leads to inner contradictions and provides a poor basis for explanation and prediction. Instead, it seems imperative to take on board cognitive psychology and communication theory in order to get more convincing explanations of why and how citizens vote, why and how they create and

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<sup>21</sup> See many contributions to Rowley/Schneider/Tollison (eds. 1993), to Monroe (ed., 1991), or the discussion of Green/Shapiro (1984) in the *Critical Review*, vol. 9 (1995). See also Udehn (1996).

communicate their political opinions. In the realm of low cost decisions, *homo oeconomicus* finds not enough reasons to act as he should and the economist finds not enough reasons to expect the same results “as if” his *homo oeconomicus* was still out there. If the defences, which still hold rather strong in the economics of market transactions, brake down in the economics of politics, Public Choice is in trouble. But instead of giving up the field, it seems advisable to seek allies, e.g., from theories of bounded rationality, cognitive dissonance, prospect theory, belief formation or preference falsification. These theories are much in line with Schumpeter’s “vision”, but they provide “conceptual frameworks” which are more robust and more easily reconcilable with economic analysis than Schumpeter’s classic-style generalisations.

The second major topic on the Schumpeterian agenda, political leadership, seems less difficult to be introduced into the overall research programme of Public Choice. However, mainstream neoclassical theory’s problems to integrate entrepreneurship and innovation into its conceptual frameworks hardly spur optimism that political entrepreneurs may soon be accorded a vital role in Public Choice. Here, above all the assumptions of given preferences and given “issue spaces”, together with the view that democracy is a static aggregation method, elide the political leader. However, other economic paradigms such as Evolutionary and Austrian economics, but also Institutional Economics and Industrial Organisation have provided a large stock of theories that may (with some caution) also be applied to the political field (see Wohlgemuth 2000, 2002a).

The difficult choices that “neo-Schumpeterian” new combinations in Public Choice would face are, again, best described in Schumpeter’s own words quoted from a letter written only a few months before he died<sup>22</sup>:

“The main difficulty in the case of economics is to give full scope to the socio-psychological and sociological view without sacrificing at the same time the purely analytic filiation of scientific ideas, which asserts itself all the same.”

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<sup>22</sup> Schumpeter (2000, 393; letter to William A. Weisskopf, dated November 18, 1949).

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