

Institutions and Institutional Rational Choice

EVSS/PUBA 602 Public Policy

Fall 2015

Rational Choice

- Key tenets:
 - Models and deductive reasoning
 - Methodological individualism
 - Instrumental rationality

Rational Choice

Instrumental Rationality

- *Assumptions*
 - Individuals have preferences (*about outcomes*)
 - Individuals act (choose an *instrument*) to achieve those preferences, but are faced with *uncertainty*
 - *Beliefs* connect instruments to outcomes
 - *Instrumental rationality*: Individuals act in accord with preferences and beliefs

Rational Choice

Rationality and Maximization

- *Assumptions*
 - Individuals rank order preferences over *alternatives*
 - *Completeness*: For any pair of alternatives, individuals prefer one to the other or are indifferent
 - *Transitivity*: Preference rankings are consistent
 - *Ordering principle*: Completeness and transitivity allow individuals to order alternatives from highest to lowest based on preferences
 - *Maximization*: Choosing from the top of the preference ordering

Rationality and Collective Action

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Rationality
Group Choice
Institutions

**If two people love each other
nothing is impossible...**

**Except deciding where
to eat.**



Rationality and Collective Action

- A simple example: three friends choosing a movie
 - Larry (L): Action movie (A)
 - Curly (C): Horror movie (H)
 - Moe (M): Comedy (C)

Rationality and Collective Action

- Preference rankings

L	C	M
A	H	C
H	C	H
C	A	A

- How does the group decide?
 - Option 1: Majority rule

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H
 - H wins 2-1 (C, M)

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H
 - H wins 2-1 (C, M)
 - A vs. C

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H
 - H wins 2-1 (C, M)
 - A vs. C
 - C wins 2-1 (C, M)

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H
 - H wins 2-1 (C, M)
 - A vs. C
 - C wins 2-1 (C, M)
 - C vs. H

L	C	M
A	H	C
H	C	H
C	A	A

Decision Rules

- Option 2: Round robin tournament
 - A vs. H
 - H wins 2-1 (C, M)
 - A vs. C
 - C wins 2-1 (C, M)
 - C vs. H
 - H wins 2-1 (L, C)

Decision Rules

- Round robin tournament

L	C	M
A	H	C
H	C	A
C	A	H

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H
 - A wins 2-1 (L, M)

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H
 - A wins 2-1 (L, M)
 - A vs. C

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H
 - A wins 2-1 (L, M)
 - A vs. C
 - C wins 2-1 (C, M)

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H
 - A wins 2-1 (L, M)
 - A vs. C
 - C wins 2-1 (C, M)
 - C vs. H

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

- Round robin tournament
 - A vs. H
 - A wins 2-1 (L, M)
 - A vs. C
 - C wins 2-1 (C, M)
 - C vs. H
 - H wins 2-1 (L, C)

Decision Rules

- Option 3: Agenda procedure—an agenda-setter decides the order of the pairwise comparisons

Agenda I	Agenda II	Agenda III
A	C	H
H	A	C
C	H	A

Decision Rules

Preferences

L	C	M
A	H	C
H	C	A
C	A	H

Decision Rules

Preferences

L	C	M
A	H	C
H	C	A
C	A	H

Agenda I	Agenda II	Agenda III
A	C	H
H	A	C
C	H	A

Decision Rules

Preferences

L	C	M
A	H	C
H	C	A
C	A	H

Agenda I	Agenda II	Agenda III
A	C	H
H	A	C
C	H	A

- Agenda I: C wins

Decision Rules

Preferences

L	C	M
A	H	C
H	C	A
C	A	H

Agenda I	Agenda II	Agenda III
A	C	H
H	A	C
C	H	A

- Agenda I: C wins
- Agenda II: H wins

Decision Rules

Preferences

L	C	M
A	H	C
H	C	A
C	A	H

Agenda I	Agenda II	Agenda III
A	C	H
H	A	C
C	H	A

- Agenda I: C wins
- Agenda II: H wins
- Agenda III: A wins

Institutional Rational Choice

- Policy as collective decision-making by *rational* individuals within institutions
- **Institutions:** “The rules of the game”
 - Rules that influence choices, often producing an *equilibrium*: regular pattern of behavior
- Institutions:
 - Solve collective action problems
 - Reduce transaction costs
 - Aggregate individual preferences

Institutional Rational Choice

- Components of Institutions (*Shepsle and Bonchek* pgs. 299-311)
 - Division of labor and regular procedure
 - Specialization of labor
 - Jurisdictions
 - Delegation and monitoring (*Principal-agent* problem)

Institutional Rational Choice and the Bureaucracy

- What is *Niskanen's* model?
 - Public servants seek to maximize their budgets
 - The bureaucrat has *private information* (knows it's TC)
 - Bureaus that seek budgets as large as possible produce too much
 - Therefore public bureaucracies are too big, budgets too large, output more than society wishes

Institutional Rational Choice and the Bureaucracy

Principals and Agents

- **Principals:** Grant policymaking authority (e.g., Congress)
- **Agents:** Receive policymaking authority (e.g., Bureaucracy)
- *The problem(s):*
 - Information asymmetry
 - Preference differences
 - Drift

Institutional Rational Choice and the Bureaucracy

Principals and Agents

- *Solution(s)*:
 - *ex ante* controls
 - Appointment control
 - Procedural control
 - *ex post* controls
 - Budgets
 - Monitoring
 - Police patrol
 - Fire alarms