

MITOCW | 19. Making Public Policy

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RICHARD OK. Today, we're going to talk about public policy. It'll be a little US-centric. We're going to walk through Madison, **SCHMALENSEE:** talk about interest group liberalism, other political processes, and then begin the discussion of that clean coal/dirty air trading filth case, with mostly background and a couple of questions.

So I want to review from way back in February. This is almost the same slide, not quite. We talked about differences between market processes and political processes.

I will remind you that governments tend to have, need to have, a near monopoly of force. And if they're stable, they tend to have legitimacy. That is to say there tends to be a general acceptance that it's OK that they make laws and rules, that the processes are OK, that people are OK generally. Obviously, not everybody agrees, and there are people in various parts of this country who think the US government should be overthrown.

But by and large, Syria is an interesting example. The government has a near monopoly of force, clearly has very little legitimacy. And whether it's a near monopoly of force or not quite enough, we will see. We will see.

Somalia, nobody has either. So the differences between political processes and market processes-- in market processes, we think about individuals pursuing self-interest. In the political sphere, individuals are actors and so are groups.

And self-interest is not the only thing that people pursue. They pursue their view of what's good for everybody else. An awful lot of government actions are what's good for you, not just what's good for the actor.

Collective choice-- choice made for all of us, public goods, things that affect all of us, and in market processes, we think about individuals' preferences. What do I want? In political processes, you really have to think about ideologies. Ideologies are views of the proper function of society, the proper organization of society, what's good for you or what's good for all of us, but certainly what's good for you.

That doesn't arise in the market. It does arise in politics inevitably. When you're making decisions that affect the whole community, you have to have some notion of what those decisions should look like, how they should be made, and so forth. So ideology always matters.

Market processes, we think mostly about competition. But competition is not the only process in the political sphere. Certainly as we go into elections, we will think about influence.

As you watch people lining up behind Romney, you think about cooperation as a key part of the political process. And as you see people lining up behind Romney, who don't much like Romney, you see the influence of loyalty. All those processes matter-- influence, cooperation, and loyalty matter in the political sphere.

In politics, power is a goal for most of the actors, a goal in and of itself-- the ability to get other people to act in my interest or in the public interest, not in their interest. And finally, I remind you that there is no there is no perfect system. We talked briefly about this voting paradox back in February-- that it's quite possible.

Just to remind you what it looks like, we have three individuals, individual one, two, and three. Three alternatives-- individual one prefers A to B to C, individual two-- let me be sure I get this right-- individual two prefers C to A to B, and individual three prefers B to C to A. So if we vote, two people prefer A to B, so A beats B.

Two people prefer B to C, B beats C, and two people prefer C to A, So C beats A. So voting with those preferences cannot produce consistent decisions. There's no sense in asking what the optimal decision is here.

If I can control the agenda, I can determine the outcome, just the order of voting. If I want if I want A to win, I will first vote B against C. B will win. I'll then vote A against B. A will win.

And you can see if you can choose the order, you can choose the outcome. So the political system is more complicated in many dimensions than the economic system. And this last point basically says the notion that there is an optimal design for government-- this is something basically Ken Arrow got a Nobel Prize for proving in a very, very general way in 1950 in one of the shortest doctoral dissertations in economics-- the notion that there is an optimal design for government is a dream. There isn't.

This says without a dictator, you can't even get a consistent system. And that's a very general result. So questions about any of this before we go?

We talked about all of this stuff earlier. I'm just trying to get you in a political frame of mind here. Then let's go to Madison.

So Madison is writing in the context of designing a government. It's easy to forget this. Having just read this very long biography of Hamilton, I will do a little history lesson.

When the country started, if you think about it, when they sat down to figure out how the government ought to be organized, there weren't any obvious models. There weren't any republics of any size. Venice had sort of had one, but there weren't any republics of any size currently.

England had a king, and they didn't want to do a king. So how do you run a government without a king? Well, you could look back to Rome, you could look to Athens.

They lasted a while. They fell. The Roman Republic became a dictatorship, basically, and Athens fell for a variety of reasons, and really was a democracy, which they didn't think they wanted.

They wanted a republic. How would you do a republic? So it is quite extraordinary if you read what they wrote at the time.

It was, like, well, we can look at what the Romans did. But if you look at the details of the Roman setup, it was very strange. And you wouldn't want to-- people held office for a year and the nobility were the office holders. You wouldn't want to do that.

So what would you do? The first thing they did during the Revolution, they set up the Articles of Confederation. And that really was a deal between 13 independent colonies, each one a sovereign state in its own eyes.

And the Articles of Confederation didn't have any executive branch. They had Congress. Didn't set up any courts, and the Congress didn't have the power to raise money.

So the Congress had the power to borrow money. And Congress could ask the states to please send in money. And that had mixed results.

So at the end of the Revolution, there was a lot of national debt. We debt financed the Revolution, because the states by and large-- states also borrowed a lot. So there was a lot of debt floating around, but you couldn't tax.

We tried to run a government that way for a while, but that didn't make any sense. So they sat down and they drafted the Constitution. You will notice that's 10 years later, more or less.

So they tried it for a while during and after the Revolution, and then they wrote the Constitution that we now have, which everybody sort of treats as, yes, of course. That's what you would do. At the time it was enormously controversial.

It was not clear it would be ratified. There was intense opposition, particularly in New York, also in Virginia, the two leading colonies, very organized opposition. The Governor of New York opposed it.

They did not want a centralized power, which is what the Constitution did. It took power to the central government. So we think of the Federalist Papers as sort of reflections, idle commentary, people with time on their hands talking about what we intended when we wrote the Constitution.

These were political documents. Madison was, all these guys, were arguing here are reasons to ratify. Please ratify. So this was an explicitly political document at a somewhat different level than many political documents we see today, but it's important to recognize this was in the heat of combat.

This was something you dash off over a weekend and then get to the next one. This was not written at leisure in the study. So that's Madison.

And what's the problem he's addressing in Federalist 10? Max.

AUDIENCE: Faction.

RICHARD Faction, what's faction?

SCHMALENSSEE:

AUDIENCE: [INAUDIBLE] people get together for a common goal [INAUDIBLE].

RICHARD So it's not just a common goal, it's get what they want, which is not a good thing. He defines "faction," as you

SCHMALENSSEE: said, they get together. They're united and actuated by a common impulse-- I think that should be "or passion." That's my typo, or maybe it's "passion of."

In any case, the key is this last part-- "adverse to the rights of other citizens or the permanent and aggregate interests of the community." At the end of the thing in one of his illustrative remarks, he talks about a "rage for paper money or for any other improper or wicked project," dot, dot, dot. So that's the kind of thing he has in mind, that a faction might actually advocate what we carry around in our pockets every day, which when he was writing was viewed as evil.

Let's look at-- that's the problem. How, in a representative republic or a democracy, where you want the will of the people to drive decisions, how do you guard against a set of people who want to do things that basically trample on the rights of others or would harm the community? How do you fix that?

That's kind of an interesting design problem. So let's walk through it. First, could you eliminate factions? What do you say about that or what do you think about that?

Could you avoid groups of people who want to do things that would trample on the rights of others or be adverse to the long-term interests of the community? Could you eliminate it? I can't call on you again, because you've actually read the thing. I can tell. Anybody else? Kirsten.

AUDIENCE: [INAUDIBLE] to eliminate the cause, you'd have to either eliminate the people's liberty to choose or eliminate their capability to think. That would be against--

RICHARD Well, apart from universal free beer, I'm not sure how you eliminate their ability to think. He points in another
SCHMALENSSEE: direction, though, doesn't he? He says, first you can eliminate their liberty, but then suppose they were all alike. Suppose everybody were the same. If you could do that, you wouldn't have this problem.

AUDIENCE: OK, not likely, given that everybody can think for themselves, and [INAUDIBLE] people reason through things.

RICHARD People come with different conclusions. He also points to something else that leads to differences. You're right.
SCHMALENSSEE:

He says, you can't eliminate liberty because that's the whole point of the exercise. You can't eliminate differences because people will have different opinions. He points to a particular, and something we see these days, a particularly important source of differences of view. Casey.

AUDIENCE: Was it property?

RICHARD It was property, yeah. He says just the way life goes, people accumulate. Some are rich, some are poor, some
SCHMALENSSEE: have a lot, some have a little. That divides their interests.

Rich people and poor people have different interests. They're going to have different views. So you can't keep them from expressing their different views.

That would be to eliminate liberty. That would be unwise. And it would be impractical, he says.

Of course, the Communist argument was, no, no, no, we should eliminate differences in property. That will take care of it. He calls that "impractical," which is pretty good diagnosis in advance of Marx.

So if you're going to have factions, how do you deal with, let's say, a small one? Is that a problem? Is that a problem you have to worry about?

We don't have to have read Madison to think about this. Suppose you're voting. Is a minority faction a problem? Say why.

AUDIENCE: As long as they accept the [INAUDIBLE] outcomes.

RICHARD As long as you're staying within the rules of the game, a minority faction loses. They lose the vote. OK, that
SCHMALENSSEE: ought to take care of that.

Now he says, suppose you have a pure democracy. You have a small number of people gathered in a room, or a small village, and it's one person, one vote. Can you ever eliminate the problem of a majority faction, which is clearly now the problem to deal with?

You have the problem of a majority that wants to trample on the rights of others. Can you make that unlikely, or rule it out, or rule out its effects when you're small enough to have a pure democracy-- no representation, just everybody votes? Charlotte, you keep waving your hand. I keep thinking you're raising, but you're not raising it, are you?

AUDIENCE: I mean, no, you can't eliminate it [INAUDIBLE] democracy--

RICHARD Exactly.

SCHMALENSSEE:

AUDIENCE: Because that's how it is, unless you change the way they're thinking, which [INAUDIBLE] can't do. But if more people want it one way, then they're going to win.

RICHARD They're going to win. And majority factions can happen because you can do influence. You can do various other things. So his answer is, no, you can't.

So he says, OK, and then he makes an argument that what you really want is a large republic. That's the way to deal with the problem of majority factions. Why? He gives two basic reasons, one of which I think is wrong. Jessica.

AUDIENCE: One of the things is because he gives some sense of equal power, so the bigger party that can decide where that faction is going.

RICHARD Well, I don't know what you mean by "equal power." He says if it's large, there'll be diversity. But push that a little more. What do you mean by--

AUDIENCE: A greater-- the people ruling no matter how [INAUDIBLE] will be able to somewhat-- it's sort of to the [? knowledge ?] in a way, to have one of the final says. And then it's not a pure democracy.

RICHARD Well, he has in mind a republic or a representative democracy. He has in mind a situation where people are elected from around the country, and those people are the ultimate decision makers. So where they're elected, you could imagine a majority faction, maybe. But Kirsten, you wanted to--

AUDIENCE: You made the assumption that elected officials would represent the public good, [INAUDIBLE] particularly necessary. And he--

RICHARD He kind of hints at that direction, but he points someplace else. He does sort of say that. And then he does say, at some point, that you can't count on it.

He says, "It is vain to say that enlightened statesmen will be able to adjust these clashing interests. Enlightened statesmen will not always be at the helm." So he points in that direction and then backs off.

Somebody else? Julian, what do you think? Forget Madison, what might solve it?

AUDIENCE: [INAUDIBLE].

RICHARD Yeah, but he's not there. He's not there. Yeah.

SCHMALENSSEE:

AUDIENCE: You can induce compromise by having representatives be responsible for being accountable to lots of people or by having enough people that, on any given issue, they might fall into a faction, but you start compromising because different sets of you will be in different [INAUDIBLE] issues.

RICHARD SCHMALENSSEE: That's a process issue, and maybe you can make sure that kind of process is followed, although if you look at how the Constitution works in the US, you don't necessarily see that happening. But he has in mind a structural difference that-- think back to what the country looked like when he was writing.

No electronic media. Weeks, months to communicate north to south, east to west, lousy roads. Most rapid, most efficient communication would be by sail, by the ocean or on riverboats. Boston to Philadelphia would be, say, to go to the Constitutional Convention, would be measured not in hours but in days, or maybe weeks, depending.

You had very different interests. You had people trading on the coasts. You had people farming inland. You had heavily slave-dependent societies in the South. You had some slavery in the North, but not as much.

And he basically argued that that might be enough to do it. How could that work? That might be enough to solve the problem. I mean, he doesn't say that explicitly, but that's the world in which he's writing.

OK, Chad, you want to take a shot? Don't want to take a shot. Andrew, you want to take a shot? Go ahead.

AUDIENCE: OK, so I'm just thinking this way and that's probably confused [INAUDIBLE]. And I think it's if we have bigger majority, it will be smaller relative to the other one, meaning if the republic is bigger, then the majority will not be as big as [INAUDIBLE].

RICHARD SCHMALENSSEE: That's close to it. He argues if it's big, you're likely to have local factions. That'll happen. You could have a majority of the people in South Carolina want slavery forever in the Constitution or not in the Constitution.

They want some law strongly favoring slavery, but that's South Carolina. And if there's enough diversity, you could have local factions, but not national factions. This is his basic argument.

He has two arguments. One is he says if there are larger districts, if you have a large republic, then everybody's going to be elected by more people. And you'll probably get better candidates that way.

And he says, let me get this-- "The proportion of fit characters be not less in the large than in the small republic, the former will present a greater option and consequently, a greater probability of a fit choice." And he says also, "As each representative will be chosen by a greater number of citizens in the large than in the small republic, it will be more difficult for unworthy candidates to practice, with success, the vicious arts by which elections are too often carried." He was not thinking of attack ads on television, however, which are more easily done in large than in small districts. So I'm not persuaded by that.

His second argument, though, is the one we were inching toward, is extend the sphere. Make it larger. Make it more diverse. You make it less likely that a majority of the whole country will coalesce around a particular bad idea, a majority of the whole.

Or if, in fact, a lot of people think that, just because the place is spread out-- again, no electronic communications-- the place is spread out. They won't be able to find each other. It'll be harder for them to discover their own strength and act in unison.

So he argues we can deal with this, basically, by you have a large republic. You have a lot of parties and interests-- and I'm going to spend time on parties and interests. You make it less likely that among all that diverse regional and industrial and whatever interest, you will get a majority of the whole country pointed in an unpleasant direction. You'll get competing, diverse interests.

He also is relying on the fact that it will be hard to organize if they're all spread out. I'm going to come back to that, too. I don't think it's as true now as it was then, but there's still truth to it. You see, this one I think is a little odd.

I once remember-- you've never heard of Alan Simpson unless you really follow politics closely and you've heard of the Simpson-Bowles Deficit Reduction Panel. Alan Simpson was about 6 foot 5, one of the funniest men in Washington. And he was a Senator from Wyoming, a Republican Senator from Wyoming, who had a whole set of opinions on a whole set of issues that were not particularly orthodox Republican positions.

And I remember somebody telling me that Wyoming's a small state. He can actually sit down and explain himself to people. In California, you have to communicate by television in 30-second spots. Simpson can go around and talk. So it's not clear to me you get better candidates and better positions in large districts.

But that's the solution. And in this solution, you get a model of politics, sort of. The model of politics is a great variety of parties and interests competing, making it impossible or unlikely that a big, single group will form and trample on the rights of the minority, or be able to get something stupid passed-- something really stupid passed. Make some sense? Yeah.

AUDIENCE: --argue that the same process kind of makes it harder to get anything passed, get anything done.

RICHARD Well, the US Constitution is distinctive internationally in how many obstacles it puts in front of getting anything
SCHMALENSSEE: done. There was this great fear of mob rule. There was this great fear.

They'd had a king, so you don't want the president to be too powerful. So you put a House. You put a Senate.

And you're afraid that the House may be governed by mob rule because it turns over every two years. So you have the Senate that's supposed to be deliberative, and more aristocratic, and slower. And then, although they hadn't really thought of it, they got it pretty quickly-- you have the Supreme Court that has the ability to say this violates the Constitution. It isn't in the Constitution that the Supreme Court can do that, but the Supreme Court asserted it could, and it did, and has.

So the US system-- it's actually hard to explain to people outside the US that we do not have a government in the sense that they have a government. In a parliamentary system, the coalition that controls parliament names the prime minister. If the government of which the prime minister is the head introduces a major law or introduces a budget and it doesn't pass, the government falls. You have another election.

So when the prime minister says we're going to ratify this treaty, he either ratifies the treaty or he's gone. We have nothing like that. We don't have a government that can make promises. Most countries do.

So you're right. We set it up so we don't have a king. We don't have the House of Representatives in charge. To a first approximation, we don't have anybody in charge.

Now, in the 18th century, this was considered a good thing. It still has its merits. It means it's hard to act in haste.

One of the critiques of parliamentary systems is they can go from a set of left-wing policies to a set of right-wing policies with one election. We move more slowly, for better or for worse. But you're right-- the whole Constitution is designed to prevent action to a first approximation.

OK, Madison's model, then, is one of competing interest groups. Factions are inevitable, but if they're weak, if they're small and weak, they don't dominate. And it's interesting-- if you go from Madison, and I must say I'm sure you all find [? Loewy ?] easy to read. I find him almost incomprehensible, but this is a standard text.

He argues-- this is written in the '60s, but I think it's still implicitly true-- that competition among interest groups has been both an accepted description of US politics, and politics in some other settings, and implicitly, an ideal. If you go to Washington and look in the phone book, look in buildings on K Street, you will see-- I spoke yesterday to an interest group composed of large industrial users of electricity. I was preceded by a spokesperson for the American Public Power Association, which represents municipal and cooperative power consumers.

We were sharing quarters with the American Forest Products Association, which represents timber harvesters. You can go up and down the street and there's the Department of Agriculture, set up as an interest group, basically, to represent the farm community, and on, and on. So the argument [? Loewy ?] makes is that we've moved.

And I think though he was writing in the '60s that isn't bad. That has become both an accepted description. Think about how politics are described in the press, not presidential politics, but any kind of legislative decision.

The environmental community, the Black community, women-- we describe the political process in terms of groups, often-- the Cuban community in Atlanta, blah, blah, blah. I mean, we do a lot of group description. And it's almost-- here's the next step-- it's viewed as a good thing.

And the question is, is it a good thing? First of all, is it an accurate description of politics? And I'll come back to that-- sometimes yes, sometimes no.

But first, [? Loewy ?] has a nice, little statement about if politics looked like that, could it be a good thing? And he argues you'd sort of need three pieces. First, you'd need clearly defined groups.

Large consumers of electricity is a pretty clearly defined group, but you can see it blurs. But certainly cooperative and municipal utilities that buy electricity-- that's a well-defined group. The Forest Products Association probably is.

And then there's this-- I think of it mathematically as [? spanning-- ?] the notion is that the organized groups pretty much cover the universe. Pretty much every interest that matters is represented well by an organized group, so that everybody's covered. Everybody has a group, or not everybody, every interest. So you may be represented by several groups, depending on what you're thinking about at the moment.

And then if you believe that as a statement of ideology, as a statement about how the world should work, that the role of government is basically to balance and reconcile, to do deals among various groups. You ensure access so all groups can participate. And this is his language-- "You ratify the agreements and adjustments worked out among them."

So again, you hear legislative deals in Congress. And we'll talk about at length the time after next in this case where people explicitly say, look, these guys won in Congress. And so our job is to make sure they get it. They get the fruits of their victory.

So do those makes sense as descriptions of the world as you know it? Does that make sense as a description of a good world? Catherine.

AUDIENCE: So I agree that having organized [INAUDIBLE] but the problem that he talked about business interests, like generally the interest group, but there was money [INAUDIBLE] given that Representatives in the Senate and House, they want to get re-elected. And so the group that has the most money can have a larger [INAUDIBLE].

RICHARD So you're pointing-- and I think I would, too-- you're pointing sort of to the second of those assumptions, **SCHMALENSSEE:** particularly the "adequately represent" part of it. So what you're saying is not all groups are created equal. I think that's fair. Are all possible interests represented by organized groups?

AUDIENCE: No, but I think that a group has a view, and if New York was [INAUDIBLE] large enough to influence, then I think [INAUDIBLE].

RICHARD Who represents the interests of mobile phone users? Is there an organized group? Or buyers of milk-- we have a **SCHMALENSSEE:** federal milk price support program that's designed to raise the price of whole milk.

The dairy farmers are an effectively organized group. People who give milk to their kids, not so much. So I would point to both parts.

I agree with you. I agree with you on the second-- not all groups are created equal, so you don't necessarily get the kind of balance you might like. But I'm not sure they fill up most of the sectors of our lives. And what's interesting-- yesterday was a good day for anecdotes.

So the speaker from the Public Power Association said she was very happy to be addressing these large industrial consumers because, she said, your group and my group are the only ones that represent consumers of electricity, which probably makes sense. Small businesses aren't represented in Washington as consumers of electricity. There is a National Federation of Independent Businesses, but it's got a lot of issues.

Nobody's representing me as a consumer of electricity, as far as I can tell. So when we were talking particularly about the FERC, when there is a proceeding, a regulatory proceeding at the FERC, a notice goes out. You don't see it. I don't see it.

They see it. That's their job. They're in Washington. And they respond to it. And with some luck, they respond as consumers of electricity, but they're consumers of electricity with particular interests. They don't necessarily represent me.

AUDIENCE: [INAUDIBLE].

RICHARD Yeah, but look at all the residential users of electricity. That's a lot of volume. Hard to organize, though, hard to
SCHMALENSSEE: organize. So that's one kicker. Anybody else? I picked on Catherine enough. Charlotte.

AUDIENCE: I just had a question. So one of the things you were listing earlier about things that Madison was considering factions, like slavery or trade, those are all things that I think of as having to go with a political party, whereas the things you're talking about now as factions are things that I wouldn't think about having to do with a political party. So I guess how is Madison relating factions to political parties or what was the situation then?

RICHARD They actually hoped, a number of them early on, that you wouldn't have parties, which was really pretty--
SCHMALENSSEE:

[INTERPOSING VOICES]

AUDIENCE: There'd been a loyalist person that [? hadn't ?] developed another one yet [INAUDIBLE].

RICHARD No, I mean, Washington had sufficient charisma that until you began to coalesce opposition to Washington, and
SCHMALENSSEE: in particular to Hamilton-- Hamilton had a particular agenda for the central government, which is to strengthen it. And Jefferson, and soon Madison, opposed that strongly. But--

AUDIENCE: [INAUDIBLE] also some sort faction [INAUDIBLE]?

RICHARD It's interesting. And that was a fear, that if you manage to get a large parity as faction, you could have exactly
SCHMALENSSEE: the problem that Madison thought of, which is one reason why they didn't like parties. Traditionally, American political parties have been pretty big tents.

They've represented a lot of different interests that didn't see eye to eye on all issues. In the European tradition, parties tended to be narrower. So you'll have the Labor Party in Britain, which is was a left party, but traditionally really was aligned with the labor movement, as the Democratic Party was and is, but much more tightly than the Democratic Party. So I think it depends on the nature of the party.

And in some parliamentary systems, you have very little parties that are focused on particular issues. Think about the ultra-orthodox parties in Israel, for instance, or some of the far left parties in European politics. Our parties have traditionally not been easily identified with particular factions.

And there isn't a-- well, I'm going to talk about this, but most of the interest groups we see in the US try very hard not to be identified with one party or another. Because you don't want to-- if you could possibly be friends with everybody, you can survive. Pro-choice, pro-life, they have not been able to do that trick. There's a Republican side and a Democratic side, and there they are.

But most-- the Forest Products Association, I am sure, contributes to people from both parties. The large consumers of electricity, I'm sure, contribute to people, et cetera, et cetera. So good question, though. Anything else?

OK, so I guess I'm inclined to agree with, I think with Catherine, that this probably doesn't work as well as one might like. I don't know whether it's an ideal, whether it would work as an ideal or not. It's not a bad story.

But the notion that pretty much all interests are represented and they're well represented, and that government is about-- modulo the role of parties-- is about refereeing agreements and adjustments among interest groups, is not a bad description sometimes-- sometimes. Once again, sometimes. But I'm not sure it's an ideal.

OK, let me move on. A little bit about interest group competition-- first, if you think about interest groups, their ability to organize is really key. Those large consumers of electricity-- there are about 40 of them-- they're the big industrial buyers. They sit in a room.

Small consumers of electricity-- there are many of us. We also have different interests. We're in different parts of the country-- hard to organize.

The more important an issue is-- that should be higher dollar "stake," not "stage." I'm looking at that and saying that makes no sense-- "stake." Electricity is 2% of the average family budget. You're not going to get families to rally around electricity rate reform. It's just not important enough.

It's a big deal to the big guys. They'll send people to Washington. And there are a small number of them, so they organize.

So a classic example is debates about airline deregulation back in the '70s. The airlines were well organized, were very important in Congress. Most did not want to be deregulated, thank you very much.

Travelers did not have an interest group. There is an Airline Passengers Association. I have no idea who belongs to it, but not a particularly important group. Nonetheless, they were deregulated, something we may come back to.

But the shorthand in politics is a concentrated interest, an interest that affects a small number of people and has a big stake for each one, tends to be a potent interest. So back to are all interest groups created equal? Well, no. Some groups don't organize.

Back to regulating electric utilities-- the utility cares an enormous amount about the outcome of regulation. Those of us who buy care a little bit. There are a lot of us. We don't have that much influence, except from time to time. So a key factor is how easy is it to organize in terms of interest group competition.

Money-- money is interesting. The simple assumption is that you buy votes with campaign contributions, and some of that does happen. But if you look at the pattern of spending, people contribute to politicians of both sides.

If you become chairman of a congressional committee, you will get campaign contributions from anybody your committee touches. Usually, what you want to do is you want to make sure your friends win. It's harder to make somebody make a 180-degree turn, or even a 90-degree turn on an issue than it is to elect somebody who already agrees with you.

So an awful lot of what goes on is electing friends and getting access. Getting access-- if you've given a lot of money to somebody, they will return your phone call. But it's amazing-- people who have no challenge, no effective opposition, will get campaign contributions from people who disagree with them on issues, just because I want to be able to get in the door.

I want you to think well of me. If I think you can be beaten by somebody who I like better, I will pay a lot for them. But it's pretty hard to buy votes with campaign contributions.

The other thing-- and this all merits discussion-- the other thing that has to be mentioned is the Citizens United decision, which is this recent Supreme Court decision that said corporations are people and limits on spending are limits on speech. So you saw it in the primary. You didn't see it here particularly, but other people saw it.

There's really no limit on what can be spent to support a candidate by wealthy individuals, mainly, more than corporations. We talked about corporate political action. But that may change things dramatically.

And it goes back to Catherine's point about money. If you're free to speak with your \$5, and I'm free to speak with my \$50 million, we have different impact. So can I get my friends elected? Well, yeah, probably.

Can I buy votes with it? Buying votes is hard. Getting friends elected is easier. So we're going to see more of that. We're going to see a lot of-- this will be a very ugly Fall. That's all I have to say.

Comments on any of this before I go to the last one, last point here? Reactions, thoughts? Jacob, you look disturbed. David is disturbed. David.

AUDIENCE: Don't [INAUDIBLE] speak with their money, and you determine what you care about more. So I buy electricity. It's only 2% of what I have, so I don't care about that that much, but maybe I care more about milk or something. So how do I choose? How do I vote what percentage of my care I want to send each group? [INAUDIBLE].

RICHARD I mean, you as an individual or you as a really rich person?

SCHMALENSSEE:

AUDIENCE: Rich people are individuals, too, right?

RICHARD Yes, yes, yes, yes. Which are you imagining yourself to be, you or a Warren Buffett? Because the answer differs.

SCHMALENSSEE:

AUDIENCE: OK, yeah, for someone who maybe doesn't have a lot of money.

RICHARD Somebody who doesn't have a lot of money, you basically belong to an organization. You care about gun rights,

SCHMALENSSEE: you belong to the National Rifle Association. You care about abortion, you contribute to the National Abortion Rights Act, whatever the thing is, or Planned Parenthood. You can contribute to organizations or you can contribute to candidates.

If you're Warren Buffett, you can set up a political action committee-- he doesn't do this-- put a few tens of millions of in it, look around the country for candidates you like, and spend for them. You can't give it to them. You can spend for them. You can hire people to write attack ads against their opponents and put a lot of money in television, or you can also find interest groups.

AUDIENCE: My question is if I care a lot about-- I have a [INAUDIBLE] because I buy electricity [INAUDIBLE], but maybe I really care about guns or something. So what would the ideal system be in which I can have interest in all these different groups, but the ones that I care about more get more of my support.

RICHARD Well, if there are organizations-- I mean, the National Rifle Association is politically active. So if you care about guns, that's a place you can send money. They'll spend it for you. If you're old you, the American Association of Retired Persons-- I mean, there are plenty of pockets.

AUDIENCE: The things that I care a lot about I can give more money to than other things. So that works--

[INTERPOSING VOICES]

RICHARD Sort of.

SCHMALENSEE:

AUDIENCE: --money But then my voice is smaller because I have less money in total. So someone who maybe doesn't care as much about this can give a little money, too, but still larger than my voice. So money seems like the most efficient system that I can think of that allows people to contribute to things they care about a lot, and have their voices heard there, whereas things they don't care about, but they're part of, they don't--

RICHARD The issue that disturbs people is sort of twofold. One of the things that's happened in this country over the last 30 years, maybe goes back a little farther, is increasing inequality of income and wealth. I think it's very hard to point a policy finger at what's done that, and it's very complicated to figure out what's done it, but it has happened one way or another.

And so the thing that upsets people is the difference in the size of Warren Buffett's voice and your voice. If it's one person, one vote, we don't all have equal impact on the process with contributions. In fact, they differ by several multiple orders of magnitude. That's the upset.

I have no problem with-- and the campaign finance laws were supposed to deal with that. The idea was A, corporations can't make political contributions, and B, there's a limit on how much an individual can spend. That was intended to equalize voice. You can still give to various organizations as much as you want, but in terms of the electoral process, there were limits.

Those laws are no longer relevant because of Citizens United. I mean, that's the issue. I mean, I've got no problem with people spending money.

I'm not profoundly upset at the current system, but the huge difference in the ability of somebody like this casino owner who gave \$15 million to the Newt Gingrich campaign-- that's one guy carrying a presidential campaign. Wow. That no longer sounds like Athenian democracy. Yeah.

AUDIENCE: Two points-- one, couldn't a voucher system solve this problem? Like something proposed by Lawrence Lessig.

RICHARD Say what you mean by a "voucher system."

SCHMALENSEE:

AUDIENCE: So what Lawrence Lessig says is that each individual has \$50 tax credit, and that money goes towards funding a candidate. And there's no other outside--

[INTERPOSING VOICES]

RICHARD Yeah, it's the "no other outside money" that violates the Constitution, almost certainly. So let me move forward a little bit.

AUDIENCE: [INAUDIBLE] second part.

RICHARD Yeah, please.

SCHMALENSEE:

AUDIENCE: Wouldn't pure capitalism solve this problem because the governments aren't involved then. And if you're buying milk, it's the consumer [INAUDIBLE] supply.

RICHARD Oh, you're saying that you should limit the scope of government so you can limit the mischief it can do.

SCHMALENSEE:

AUDIENCE: In theory.

RICHARD Sure. Why are we trying to raise the price of milk, for heaven's sakes? Because dairy farmers are a very effective

SCHMALENSEE: organized group and have been. Why do we raise the price of sugar? Because if we didn't have barriers to trade in sugar, we would undoubtedly buy Cuban sugar, and we don't wish to buy Cuban sugar. Oh, and by the way, they're sugar producers.

Anyway, lobbying-- let me urge you read the short piece by [? Kline ?] and [? Steller. ?] It's not on the syllabus because it came out this spring. It's a very nice description consistent with all my experience of how lobbying works.

Effective lobbyists don't walk in with bags of money to buy votes. Effective lobbyists make friends. They get in to talk.

They provide information. The information is, of course, slanted, but it's your friend. It's a very interesting description of what the guy calls a "gift economy," where basically you're doing favors.

You have a complicated piece of legislation. I'll discuss it with you when we play golf next Saturday. We're good friends.

How did I get hired as a lobbyist? Because I'm friends with these people. That's how I got hired as a lobbyist, so they'll play golf with me, so I can tell them this stuff.

Yeah, maybe I give them some tickets, but I'm not going to buy their votes with money for a whole set of reasons. First of all, you go to jail for that if you're caught. And second of all, most people in Congress don't think of themselves as crooks. They think of themselves as trying to do the right thing.

So the process of lobbying is very, very nicely described in that article. And again, it's because I've seen it, it's consistent with everything I've seen. You become an effective lobby not because you have more money to swing around, but because you can hire people who have connections. You can get information prepared that's useful, and you have the ability to affect campaign contributions. That does matter.

But it's a very different process. It's a process of influence, not a process of bribery. So I urge you to read that. It's short.

So quickly, [? Loewy ?] makes the point interest group competition is one kind of politics. It really is inside baseball. But if you look at various kinds of political action and various kinds of governmental action, it doesn't all fit.

This is a set of possibilities. This is impact on the Federal Reserve. Well, is that interest groups? Antitrust policy-- is that interest groups?

Reapportionment-- well, that's more complicated. Tariffs-- tariff policy is winners and losers. Milk price supports is aiding constituents. Regulation-- can you make products safety regulation interest groups? Not too easily.

So the [? Loewy ?] point, and you can read the text around this to interpret this diagram, is that that doesn't always describe politics well. I'm going to come back to that when we talk about regulation. There's also other models.

Now, this is the piece by Whitt. And Whitt is a Marxist, so Whitt is very big on class dialectic. And if you can make sense out of that, you're one up on me. But I think the middle column, the split between the two columns is interesting.

If you think about politics in China or if you think about traditional politics in Latin American countries, where they would talk about the oligarchy, you would think about this middle column. You would think about politics by the elite. Read descriptions of politics in Haiti, et cetera.

There are a number of situations in which it makes sense to think about. And if you read older descriptions in Boston of the vault, which is what all the business and civic leaders would get together in the vault of the Bank of Boston, you sort of have a politics that doesn't look so much like this. This is really a [? Loewy ?] description over here, a very nice [? Loewy ?] description of how it ought to work.

But in fact, there are situations in which in essence, there is a relatively small elite that controls the government. They may control the government for exploitation. They may control the government for who knows what, but it's a club.

It's a small club. And there are situations that look like that. The US doesn't look like that so much because our politics are less well organized.

Latin countries always used to look like that. They're less so now. But again, listen to [? Evita ?] and hear them talk about the oligarchy.

So there are a number of settings in which it makes sense to think about the politics as elite control, not interest group competition. You might think about that. There are also situations that don't fit any of these, and I'll talk about some of those.

What I want to do now is begin the lead into the discussion of clean air as an example where a number of these and some other things surface. So I realize that to do that case, you have to have a little background on the structure of federal regulation. And let me do that now. Please try to stay awake.

The way the US system works, typically, is laws are vague. Laws say things like, "EPA must set a standard to protect human health," or "the public utility commission shall ensure that electricity prices are just, reasonable, and not unduly discriminatory." Very commonly, this is a very standard-- sometimes that's handed to a cabinet department-- the Department of Agriculture, the Department of Interior, whatever.

Sometimes, it's handed to an agency. We're talking here mostly about agencies. They come in two forms-- they're either independent or they're part of the executive branch.

If they're part of the executive branch, like EPA, the President appoints the head. The President can fire the head. If they're independent, the President will be able to appoint the head but not remove them, except to show cause.

You can fire the head of EPA because he or she ticked you off. To fire the head of FERC, you have to show cause. That can be challenged in court, and so forth.

So they are independent. They were invented around in the teens of the last century. The idea was to make them-- well, there were some earlier examples, but it was really pushed then.

The idea was these will be expert bodies immune to politics. The Federal Trade Commission is one such like that it. It has its own building. It gets its money from Congress. It doesn't report to the President. The President appoints people with the consent of Congress, can't fire them. Often, they have to be bipartisan-- two Republicans, two Democrats, something like that.

They could be captured. They could be captured by the regulated interests. It's argued that FERC is captured by the utilities. I don't think that's true, but you can make the case.

And the idea of putting EPA, which is a later creation, in the executive branch was to make it responsive to politics, make it responsible. It affects the kind of oversight. Rules passed by EPA, rules proposed by EPA, are reviewed by the Office of Information and Regulatory Analysis in the Office of Management and Budget.

They can be called in on the carpet. They can be fired. All kinds of things could happen. The Federal Communications Commission, or the FERC, or state public utility commissions, are not reviewed in that fashion by the President, or the President's people, or the governor, or the governor's people.

But all decisions by regulatory agencies can be reviewed in the courts. So here's the architecture. The law says it's got to be just and reasonable. It's got to protect, blah, blah, blah.

In some cases, the President or the governor can review it, more commonly not. It gets reviewed by the courts under the Administrative Procedures Act of 1946, or related state acts. The court can reject an action that's arbitrary and capricious, an abuse of discretion, or not otherwise in accordance with the law.

So the law says you have to protect human health. The agency has no evidence on health. The court will say, that's arbitrary and capricious, and throw it out. Or you didn't take into account public comment.

So here is where organized interest groups matter. So the agency is going to make a decision. It has to take comments, usually.

And the American Public Power Association will file comments on everything. e which is this electricity consumers organization, will file comments on everything that has to do with electricity. You and I won't. As will every utility in the land, and who knows, General Electric.

Organized interest groups will file comments. And the courts will reject a rule that doesn't take adequate account of public comment. So if somebody proves that a chemical is cancer causing, and EPA says, no, it'll be thrown out.

You've got to consider the evidence that's submitted in the process. That's the regulatory process, particularly as it relates to environmental regulation-- fairly vague laws, not always, not on all terms, but usually fairly vague, hands it off, delegates to the agency. Sometimes, in the case of EPA, reviewed by the White House, sometimes not. Always reviewable by the courts, always a requirement to take into account comments.

You might ask, who would work in a regulatory agency? And we'll talk about that briefly. But is that process reasonably straightforward? Yeah.

AUDIENCE: Would it take into account who's making the comments?

RICHARD No. You take into account the evidence provided. So if the large electricity consumers, say, we think that rates

SCHMALENSEE: too high, well, there's nothing to take into account. If they say, here's a study that shows that 10% of our members will be driven bankrupt by these prices, and the study is not junk, they have to consider that.

So they're not obliged, in fact, they're almost obliged not to take into account the source, but to focus on the content, which is sort of sensible. Yeah. Anything else? Yeah, you actually have to make arguments.

OK, so we've been talking about interest group politics. We're talking about factions. How did that act get passed?

Was that interest group competition? Did interest group competition give us the Clean Air Act of 1970? And if so list the groups.

Clean Air Act of 1970 was a strong assertion of federal power over the environment. It in effect-- didn't quite, but in effect-- created EPA. Put in the architecture for air pollution control, water pollution control-- well, the air pollution control-- that still governs. Took power from the states. Interest group competition? Brendan.

AUDIENCE: [INAUDIBLE] competition between environmentalists and those maybe people who were using chemicals that the Clean Air Act was [INAUDIBLE] against?

RICHARD Well, environmentalists-- let me push you a little farther. If you go back to 1960, could you find

SCHMALENSEE: environmentalists?

AUDIENCE: No.

RICHARD What happened? I think it was 1970 or close to 1970. There was a big event.

SCHMALENSEE:

AUDIENCE: [INAUDIBLE].

RICHARD Earth Day. Earth Day. That was when people started talking not about environmentalists, but about the

SCHMALENSEE: environmental movement. You began to hear the word "movement," just as you start to hear about the Tea Party movement, the Occupy Movement. You started to hear about the environmental movement, the civil rights movement.

Those aren't really interest groups. We'll talk Monday about what they are, but social movements are a bit distinct from organized interest groups. They're certainly distinct from organized political parties.

Yet every so often, they get something like that passed. Richard Nixon was not an avid environmentalist. This was not a Republican issue, to say the least.

There was no industrial support for the cleanup, maybe a little industrial support, because the state rules differed and that was a little problematic, but not much, not noticeable industrial support. That was a social movement. Who was it was telling me about all the "No fracking" signs in New York State, somebody who sits over here?

AUDIENCE: [INAUDIBLE].

RICHARD Yeah, that's a social movement. That's not an organized interest group in the sense that the American Forest
SCHMALENSEE: Products Association is or the American Public Power Association. That's a bunch of people who get very upset about fracking, and who by god make noise. That's what got us the Clean Air Act.

We may need that to do something about climate change, but we don't have a social movement in that direction quite yet. But we did have interest groups after '71. So who were they? Who were the interest groups affecting SO2 regulation from power plants?

And we're going to walk through the case next week. So please, please do get it. Anybody? Has somebody looked at the case? Who were the groups? Sarah.

AUDIENCE: [INAUDIBLE] coal power plants who [INAUDIBLE] their facilities and where they get their coal.

RICHARD So you had utilities with coal-fired power plants. Who else?

SCHMALENSEE:

AUDIENCE: You had utilities as well, utilities.

RICHARD Utilities, yeah, with coal-fired power. They owned them. Everybody was vertically integrated in those days.

SCHMALENSEE: Utilities with coal-fired power plants and--

AUDIENCE: Environmental concerns.

RICHARD Environmentalists, yeah. They were pretty well organized by then.

SCHMALENSEE:

AUDIENCE: Coal producers in the East and in the West.

RICHARD Coal producers in the East and in the West, two distinct groups. Eastern and Western producers, electric utilities,

SCHMALENSEE: Western states a little bit on some of the prevention of significant deterioration, and the environmentalists-- who wasn't represented? Anybody? To go back to [? Loewy, ?] are there any interests, not interest groups. Are there any interests, David?

AUDIENCE: We all buy the electric power [INAUDIBLE] price [INAUDIBLE] affects us [INAUDIBLE].

RICHARD So consumers weren't represented, except maybe indirectly by electric utilities who wanted to keep their costs

SCHMALENSEE: down. So you're not represented as a consumer of electric power. Any other interest, Charlotte?

AUDIENCE: Maybe the people who are near the power plants who would be affected by pollution.

RICHARD People who breathe air, right. Yeah. So the environmental groups, in a sense, are indirectly representing that **SCHMALENSEE:** interest. As we'll see, they also had other interests. So I don't know, I think those are the main ones that I think of. You had more. Oh, I thought you were-- just waving, OK.

OK, how did the act set it up? Who did what? What did EPA have to do? What did the states do?

What about new plants? What about old plants? What was the design? Who did what, the '70 act set up. Casey.

AUDIENCE: The EPA set overarching air pollution limits, and then each state would have to figure out how they were going to [INAUDIBLE].

RICHARD So the EPA would set air quality standard, national ambient air quality standards. And then it would, as regards **SCHMALENSEE:** existing plants and existing facilities, ask the states for state implementation plans to meet those requirements. Absolutely right. What about new power plants?

AUDIENCE: There's a different set of regulations for them. [INAUDIBLE].

RICHARD Set by--

SCHMALENSEE:

AUDIENCE: Set by the EPA.

RICHARD Set by the EPA-- so the EPA didn't set standards or rules for existing plants. It set air quality standards. Let the **SCHMALENSEE:** states figure out how to do that. But for new plants, there were national standards for new plants.

What's the basic rationale? Why would you treat new and old plants so differently? Matthew.

AUDIENCE: Because the existing plants, in order to retrofit them, you would need expensive equipment. It might not even be worth it. But the new ones, they can design it so that [INAUDIBLE].

RICHARD So that's the basic rationale exactly-- that new plants, in a sense, you've got a blank sheet of paper. And you can **SCHMALENSEE:** design the plant to meet this standard. Old plants differ in so many ways that there's no easy way to use the same standard across all old plants.

It would be easy for some, impossible for others. Let the states figure it out. That is exactly the basic rationale. We'll come back to sort of how that worked.

So what we're going to do in the next two sessions, we're going to talk about social movements on Monday. And one of the reasons we're talking about social movements is that that's what got the '70s act passed. The Civil Rights movement got civil rights legislation passed-- not an organized party, not quite an interest group, not the American Forest Products Association. And then we'll come back to this case, and we'll talk about how we got the politics of the standards, the two sets of standards, the acid rain impasse, emissions trading, other stuff. Thank you.