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Bounded Rationality and “The Institutional Foundations of Democratic Government”

Comment

by

ARTHUR LUPIA *

1. Introduction

In “The Institutional Foundations of Democratic Government: A Comparison of Presidential and Parliamentary Systems,” MOE and CALDWELL [1994] present a novel argument about how democracy works and whose interests the actions of government ultimately promote. The authors make their argument by focusing on the relationship between the basic structure of democracy and bureaucratic performance. They find that in a “separation of powers” system of democracy, the conflicting desires of organized interest groups, individual legislators and the president lead to a relatively ineffective bureaucracy that is buried under a mass of formal restrictions. By contrast, they find that a bureaucracy designed by a single-party-majority government, as is commonly found in Britain, will be relatively effective and “granted lots of discretion.”

Moe and Caldwell suggest that the motivation for their research is that political scientists have relatively little to offer in the way of advice about the consequences of political institutions. In my view, the remedy they suggest is reasonable. After all, the existence of law makers who produce policies that can efficiently and/or effectively coordinate citizen actions is not a sufficient condition for efficient or effective outcomes. Bureaucratic performance matters.

While I endorse their approach, I also believe that some readers may find troubling the fact that the authors describe their theoretical framework as “more suggestive than definitive” and “embryonic.” When I first saw these references, I became uncertain about how much faith I should have in the reliability of the Moe and Caldwell conclusions. Because other readers may have similar concerns, I am going to evaluate their argument using two standards that are familiar to most students of the New Institutional Economics and political institutions: inductive and deductive validity.

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Inductive Validity: If the premises are correct, could the conclusion follow?

Deductive Validity: If the premises are correct, must the conclusion follow?

There are two important reasons for making this evaluation. First, the Moe and Caldwell argument, if sufficiently valid, could have a significant impact on future discourse about the effect of institutional choice. Second, Moe and Caldwell present their argument without the formal rigor of many of their contemporaries. As a result, readers who are familiar with much of the literature on either the New Institutional Economics or the impact of political institutions may find it difficult to discern whether Moe and Caldwell's argument achieves the same standards of validity that formal work is subjected to. Furthermore, some readers may discount the Moe and Caldwell argument because the authors do not prove that these standards are met. The combination of these two factors presents the real possibility that an insightful argument may be ignored by the scholars who could benefit from it most. From my perspective, this would be unfortunate.

The remainder of this comment is organized as follows: first, I identify and evaluate the central premises upon which the Moe and Caldwell argument is based. I then identify Moe and Caldwell's major conclusions and evaluate their argument's validity. I conclude by relating Moe and Caldwell's argument to recent research in political science that identifies a relationship between the existence of boundedly rational actors and the role of institutions. I find that Moe and Caldwell's argument satisfies the standard of inductive validity. I also find that a more serious consideration of the consequences of bounded rationality could strengthen the power of the type of argument that Moe and Caldwell present.

2. Major Premises and Conclusions

The fundamental premises of the Moe and Caldwell argument can be stated as follows:

1. Legislators in the US value their own popularity and security more than they value an effective and accountable government.
2. Legislators are more responsive to organized interest groups than they are to unorganized groups.
3. Organized interest groups tend to demand bureaucratic structures that either
 - prevent agencies from performing well,
 - insulate agencies from political control, or
 - both.
4. Presidents are different. They have a national constituency and are held accountable by the public for every aspect of national performance.

5. Presidents resist specialized appeals.
6. Prime ministers have incentives similar to those of the President.
7. In a separation of powers system, it is relatively difficult to change that which has previously been enacted.

While the standard of validity depends only on the relationship between premises and conclusions, it is probably worthwhile to take a moment to discuss the viability of the premises. For even if the argument meets the standard of inductive or deductive validity, the inferential value of its conclusions ultimately depends on how reasonable the premises are perceived to be.

I suspect that few political scientists would agree that all of these premises are accurate as stated. My own belief is that premises 1, 2, 6 and 7 are well supported by the existing literature on collective action and legislative incentives (see OLSON [1968], HARDIN [1982], MAYHEW [1974] and CAIN, FERREJOHN, and FIORINA [1987] for prominent examples of these types of arguments). In contrast, I believe that premises 4 and 5 are plausible as descriptions of marginal differences between a legislator's incentives and a president's incentives, but as stated in Moe and Caldwell they are probably overgeneralizations of actual presidential incentives.¹

I have the most difficult time with the third premise. Interest groups can desire many things: some groups want government not to interfere with their affairs, while others desire government involvement. In addition, detailed and lengthy rules do not necessarily hamper bureaucratic performance, they may be necessary for actors with disparate interests to overcome collective action problems (see LOWI [1979] and McCUBBINS, NOLL and WEINGAST [1987] for contrasting perspectives on the role of rules). In my judgment, the Moe and Caldwell argument would be no less powerful had the authors instead assumed that interest groups merely had different preferences over policy outcomes and/or structure than either the typical legislator or the president. Since I believe that the latter assumption is more realistic, I believe that it would also increase the model's predictive power.

Moe and Caldwell conclude that:

1. In a separation of powers system, the bureaucracy will be incoherent and ineffective.
2. In a parliamentary system, the bureaucracy will be coherent and centrally controlled.

¹ Specifically, it is not impossible for presidents to derive a benefit from bargaining with particular groups. Stated another way, I believe that it is easy to prove that a president does not always allocate equal weight to the preferences of all possible subsets of the electorate when making policy decisions. At the margin, the president is likely to give more weight to the interests of organized groups than he is to the interests of (perhaps equally sized but) unorganized groups.

3. These differences will persist because it is relatively difficult to change the status quo in a separation of powers system.

It is a relatively simple task to verify that the Moe and Caldwell argument is inductively valid. That is, given the incentives that the authors have assigned to legislators, presidents, parliamentarians and groups, and the basic structural difference between “separation of powers” and “single-party government in parliament,” each conclusion could be true.

Unfortunately, the argument as stated does not achieve the more rigorous standard of deductive validity – the standard which could make the Moe and Caldwell conclusions more compelling if all of the premises were perceived as reasonable. While the deductive validity of the third conclusion is easily verifiable, a close inspection of the relationship between premises and conclusions shows that Moe and Caldwell’s first two conclusions are not deductively valid. To see this, consider the case where differences in legislator and presidential incentives (i.e. premises 1 and 4 are true) lead legislators to be more responsive to organized interests than the president (premises 2 and 5 are true) and where organized interest groups demand ineffective bureaucracy (premise 3 is true).² For the Moe and Caldwell argument to be deductively valid, *it would have to be the case* that the only possible outcome is an incoherent and ineffective bureaucracy. However, other substantively distinct conclusions are possible when premises 1–5 are true. For instance, if legislators are unable to observe or understand the consequences of particular bureaucratic actions, perhaps because bureaucrats possess expertise about policy that legislators do not, then they may be unable to tell whether the bureaucrat is abiding by the rules that the legislature has attempted to impose on it. *If a legislator cannot tell whether or not her rules are being followed, she may be unable to affect bureaucratic incentives and, therefore, unable to create the type of bureaucracy she desires.* So even if premises 1–5 are true, it is not necessarily the case that legislators can deliver the type of bureaucracy that interest groups are assumed to desire.

Standing between the Moe and Caldwell argument and deductive validity is a relatively serious consideration of the consequences of bounded rationality. In short, interest groups, legislators, presidents and parliaments may differ about how the bureaucracy should perform and the latter three actors certainly have sovereign authority with which they can structure bureaucratic incentives, however, desire and sovereign authority are not sufficient to mold bureaucratic performance. In order to affect bureaucratic incentives in a desired manner, a law maker must be able to adapt successfully to the knowledge she may lack about bureaucratic actions. It is to this topic that I now turn.

² For this example, premise 6 is irrelevant. Equivalent examples could easily be created using these premises.

3. *Incorporating Bounded Rationality*

An important element of Moe and Caldwell's analysis is their description of the type of bureaucracy that interest groups, legislators, presidents and parliamentarians would desire if they were able to win control of the "politics of structural choice." For instance, the authors describe a successful interest group's ideal bureaucrat as an "expert" that can be granted substantial discretion and held accountable for its actions. They go on to argue that an interest group's uncertainty about the future control of the government, and the need to compromise with other groups, leads them to advocate the development of a bureaucracy that differs from their ideal. Specifically, interest groups ultimately demand a bureaucracy that has little discretion. In contrast, I would argue that a legislative winner is generally better off creating the "ideal" bureaucrat, regardless of whether the winner wants an effective bureaucracy or a bureaucracy that is insulated from future democratic control. To see this, consider the example where a legislative winner wants an insulated bureaucracy. As I showed earlier, the existence of a set of rules under which the desired bureaucratic performance is possible is not a sufficient condition for ensuring that the bureaucracy acts as desired. The "winner" must have a way to discern the extent to which the rules he has designed are being followed.

The central problem for democracy in a complex world is that law makers who lack expertise may be unable to control their non-ideal, but expert, bureaucratic agents. That is, if a law maker cannot tell the difference between bureaucratic actions that serve her interests and bureaucratic actions that are detrimental to her interests, she may not be able to induce bureaucratic actions that have beneficial consequences for her. To understand the relationship between institutional structure and bureaucratic performance, it is necessary to consider how law makers adapt to the expertise that they want their bureaucrats to possess. Fortunately, there are two political scientists who have started us down this path.

GILLIGAN and KREHBIEL [1987] and KREHBIEL [1991] have introduced many political scientists to the importance of considering the implications of bounded rationality for the study of political institutions. Their research has created a wide interest in the interaction between perception, knowledge and institutional structure. Gilligan and Krehbiel examine an interaction between a relatively well informed legislative committee and a relatively uninformed legislature chamber. By varying the chamber's ability to amend committee recommendations, Gilligan and Krehbiel show how institutions can be designed to provide incentives for people to both acquire policy-relevant expertise and reveal the knowledge they acquire truthfully. Specifically, they identify conditions under which the chamber would be better off giving up some or all of its ability to amend committee proposals in exchange for the gains it expects from having access to the committee's expertise.

In more recent work that is directly relevant to the question of bureaucratic performance, Mathew McCubbins and I (LUPIA and MCCUBBINS [1993]) have identified conditions under which a relatively uninformed law maker can affect the incentives of an expert bureaucrat. We first argue that inducing a bureaucrat to behave in accordance with law-maker desires requires that the bureaucrat believes that the law maker is likely to have the ability to reward beneficial actions and punish detrimental actions. It follows that a law maker who wants to influence bureaucratic action must know enough to tell the difference between beneficial and detrimental actions. A law maker can use three methods to obtain this type of information: she can become an expert herself; she can rely on information about bureaucratic activity that is provided by the bureaucrat (an informed second party) or she can rely on information about bureaucratic activity from an informed third party. Each method, however, is problematic.

The main problem with becoming an expert is that it requires much time and effort. Since a law maker's opportunity costs are usually significant, becoming an expert on, perhaps, any (and certainly every) issue over which one would like to exert control is not feasible. Similarly, reliance on information provided by either a bureaucrat or an informed third party has a critical disadvantage: the "expert" may choose to take advantage of this information asymmetry and deceive the law maker. The extent to which a law maker can learn enough from a potentially unreliable information source to influence bureaucratic actions depends on either the prior existence of, or the law-maker's ability to create, incentives for informed persons to reveal what they know.

McCubbins and I identify four conditions that allow a law maker to obtain information about bureaucratic activity from an informed second or third party. While each of these conditions, stated individually, is present in various contexts within the economics literature, our approach allows us to identify these conditions' individual and interactive effects. We show that if all of these conditions are absent, a law maker is unlikely to have sufficient knowledge to either reward bureaucratic actions that she perceives to be beneficial or punish actions that she perceives to be detrimental. As these conditions arise or as their magnitude increases, the law maker can generally learn more about bureaucratic actions and is likely to experience greater success at getting the bureaucracy to do its bidding.

The first condition for learning is the degree of similarity between a law-maker's preferences over outcomes and those of an information provider. This condition is similar in spirit to that identified in CRAWFORD and SOBEL [1982]. When a law maker believes that an information provider's interests are very similar to her own, it follows that the law maker can infer that the information provider is relatively likely to have an incentive to provide truthful information. By contrast, if a law maker believes that her interests and the information provider's interests are distinct, then, all else constant, the legislature can infer that the information provider is less likely to be informative.

The second condition for learning is a law-maker's ability to observe costly action by a bureaucratic agent who possesses hidden knowledge. The logic here is similar to the idea behind the old adage "actions speak louder than words." In general, if we observe an informed individual taking actions that are costly (e.g., the action involves effort or precludes other actions being taken), then we can learn something about how the individual's preferences or beliefs about the world differ from our own (since the individual would not have paid the costs had there not been an expected net benefit from the actions taken).

The third condition for learning is the existence of content-specific communication costs like probabilistically-applied penalties for lying. If an individual faces a penalty for lying, such as an explicit fine or the possibility of a damaged reputation, then we know that individual will not tell lies for which the expected gain from lying is less than the expected penalty. The fourth condition for learning is the threat of verification. If an information provider believes that the veracity of his statement will later be revealed to the law maker, his incentives for truth telling are likely to be affected.

In sum, a law maker's ability to create the bureaucracy she desires, in a world where issues are complex, depends on the existence of second and/or third parties that are informed about bureaucratic actions and the law maker's ability to structure bureaucratic institutions in a way that creates the conditions for learning if they do not otherwise exist. When we add the consequences of bounded rationality to the Moe and Caldwell argument, we can create an argument that meets the relatively rigorous standard of deductive validity. For instance, if the Moe and Caldwell premises are true, *and if the conditions exist under which legislators can obtain sufficient information about bureaucratic actions*, then legislators will have the ability to create the type of bureaucratic structure that interest groups demand. In this case, Moe and Caldwell's first conclusion must be true. It follows straightforwardly that adding a similar assumption to the parliamentary case would render their second conclusion deductively valid as well.

4. Conclusion

Moe and Caldwell construct an argument that has as its foundation constituent preferences, law-maker incentives and the politics of structural choice; and as its fruit compelling conclusions about how the basic structure of democracy is related to government performance. The argument is novel and the findings are important and provocative. Scholars who are interested in understanding the impact of political institutions should read this article and come to grips with its conclusions. While I believe that some readers will disagree with some of the premises upon which the argument is based, Moe and Caldwell should affect the way future researchers think about institutional choice.

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