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# Introduction\*

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This book of alternative public economics deals with alternative views of current topics and with new or neglected methodologies as well as with new topics. It is divided into five sections: 'Revisiting the theoretical foundations'; 'Revisiting the values'; 'Beyond "rationalistic" rational choices'; 'Optimal government and government failure'; and 'Public economics of public bads'.

The first section on 'Revisiting the theoretical foundations' consists of five chapters on the relevance of the Austrian views, the Marxian view, the supply side economy, the Keynesian orthodoxy and the new school of the budget balance.

Pascal Salin in his chapter on 'The neglected importance of Austrian thought in public economics' explains the reasons why, according to the Austrian view, both the Keynesian and the monetary theories of the crisis and related policies are untenable. The crisis is caused by disequilibrating fiscal and monetary policies. Recovering from the crisis implies letting markets make the necessary adjustments and therefore avoiding increased public deficits and introducing more expansionary monetary policies or greater regulation of markets. The Austrian approach differs not only from the Keynesian but also from the monetarist viewpoint because it focuses on a micro rather than on a macroeconomic approach. The pathology of the boom not only consists in an excessive increase of the money supply, it is also due to its wrong directions caused by the abnormal reduction of the interest rate below its natural rate. To avoid these booms, one should not consider inflation as merely due to an excessive increase of consumer prices. Assets prices too should be considered (as Salin explains in his book *Revenir au capitalisme pour éviter les crises* [2010]) as a component of it. Therefore economic bust is needed for the elimination of various non-productive activities that arose during a period of anomalous increase of the asset prices, with distortion of their relative prices caused by an interest rate lower than its natural rate. It is important to note that Salin begins his exposition by stating that he shall present *what he believes* to be the true causes of the crisis and the appropriate policies to cope with them: a statement of limited rationality in the Hayekian spirit.

Jesús Huerta de Soto in his chapter 'In defense of the euro: an Austrian perspective (with a critique of the errors of the ECB and the interventionism of Brussels)' presents the euro as a 'proxy' for the Gold Standard and

hence of the Austrian tradition of support for fixed exchange rates versus nationalistically managed exchange rates flexibility. Under fixed exchange rates both politicians and the monetary authorities are compelled to adopt the unpopular measures and reforms necessary to obtain growth and full employment under monetary stability: that is, under an efficient framework for the functioning of the market economy. Under the euro monetary rules, given the constraint of the fixed exchange rates determined by the pursuance of the monetary stability principle, politicians shall be forced to resist the constant demands for cheaper credits, for avoidance of a rise in interest rates, for more expenditure, and so on. The badly performing countries shall be obliged to do the structural reforms needed to cope with the rate of exchange constraint that involve economic liberalization, deregulation, increased flexibility in prices and markets (and especially in the labor market), reduction in public spending, and the withdrawal and dismantling of union power and the welfare state. With the euro, despite all the errors, weaknesses and concessions, the type of irresponsible behavior and forward escape due to the Austrian monetary principle has no longer been possible.

Are Marxist public economics obsolete? This is the question dealt with in the chapter by Giuseppe Coco and Silvia Fedeli (with a comment by Massimo Florio). In the original Marxian theory, the State was nothing but a 'Committee' for the pursuance of the capitalists' interests, being those of the bourgeois class. Over time, Marxism evolved to take into account instances in which the State decisions were in the general interest of the *capitalist countries*. Subsequently, Marxist economists admitted some separation between political powers and capitalists' interests in order to compose the different interests to assure the system's stability. But this composition of interests cannot exceed some threshold; otherwise the capital will take power directly through authoritarian rule. The Marxist economic literature of the 20th century has focused on the (unexpectedly) growing role and size of the State in the capitalist economies and on the feasibility issues relating to an entirely planned economy. The growth of the size of governments is explained by their functions as stabilizers and as a way to cope with the crisis that may derive from a consumption gap (see e.g. O'Connor, 1973). An event which for Marxism is inherent to the capitalist economy. As for the functioning of a generally planned economy, most Marxian economists now admit the need for a true price system and free exchange, at least for the final goods. In the most extreme version, market socialism, if the distribution of resources is not too imbalanced, it does not require the nationalization and public ownership of all means of production; other forms of property and control of firms could be used. In general, the emphasis of Marxists' public economic theory, in its modern

versions, is increasingly on the issue of the unfairness of the resources distribution in capitalism.

Massimo Florio adds that while Keynes was distant from socialism, Cambridge economists such as Joan Robinson, Sraffa, Kalecki, Kaldor, if not Marxists, were, however, accepting some of Marx's ideas. The *Cambridge Journal of Economics* is still today advertised as 'The *Cambridge Journal of Economics*, founded in 1977 in the traditions of Marx, Keynes, Kalecki, Joan Robinson and Kaldor'. One core tenet of this Cambridge tradition is a view of income distribution, hence of saving and investment, as determined by social relations and powers: the core of Marxist theory. A version of public finance, on these principles, is different from that based on the view of wages and capital income as determined by the equilibrium in the market factors of production. The Marxist thesis of O'Connor thus re-emerges dressed in the cloth of efficiency with equity.

Two intertwined chapters follow – one by Vito Tanzi on the uses, misuses and abuses of the Laffer curve, and one by Silvia Fedeli and Francesco Forte on the long-run fallacy both of the (Keynesian or neo-Keynesian) thesis that a policy of fiscal deficits creates employment and of the current thesis that high taxes may be a good remedy to restore the budget balance.

Vito Tanzi shows the many ambiguities of the stylized Laffer curve, with its point of maximum of tax revenue after which there is an inverse relation between tax increases and revenue size. It is not clear whether this point is a maximum in the short run and also in the *medium* and *long run*; and not just in absolute values but also as a share of GDP. For a progressive tax, the average rate may be misleading and the marginal rate scarcely meaningful. Costs of collection and control should also be included. There is the difficulty of estimating the revenue effect of a change in the tax rate because other things are often changing too. Effects of regulations and deregulations, a shadow economy, tax havens and off-shore centers and various other tax planning maneuvers must also be considered. Moreover, the Laffer curve may be supported by the supply-side views of public economics because of the negative effects of taxes on production, and/or by the Keynesians because of the effects of them on demand. Tanzi's alternative view of the Laffer curve is that while there is some truth in the thesis that higher taxes may not increase tax revenue and that tax reductions may increase it, especially over the long run, this implies that there is not *one* Laffer curve, but potentially *many*. Laffer curves are country-specific, and possibly time-specific and linked with fiscal illusions brought both from supporters and adversaries.

The Fedeli and Forte chapter, with an econometric analysis of 19 OECD countries from 1981 to 2009, presents an alternative analysis of the perverse effects of budget unbalances and also of their remedy by high taxes

in the long run. The current stream of research focuses on the effects on GDP, but Keynes' 'General Theory' focus was on full employment. And politically, for the electors, employment is a factor at least as important as growth. On the other hand, the current researches, for example those of Reinhart and Rogoff (2010), focus on the debt ratio to GDP, while the basic issue of the controversy over the effectiveness of Keynesian fiscal policies is deficit. Indeed, if it is true that deficit creates employment and – via the related multiplier of the demand – GDP growth, the long-run debt/GDP overhang might not grow too much. A current standard suggested remedy is to adopt constitutional budget constraints as a balanced budget, with limited exception for the deficit corrected for the cycle, as in the European Union 'fiscal compact'. But if, as it is demonstrated by this chapter, both persistent deficit and high taxes lead to long-run unemployment, this rule would be inadequate and even dangerous. Indeed, the neo-Marxist view and the Marxist-Keynesian thesis, according to which a high welfare state is needed to make a capitalist society survive and to have efficiency with equity, is also fallacious. The conclusion is just the opposite. Constitutional rules to prevent the deficit and to limit the increase of the ratio of public debt to GDP, should also include limits to the tax burden, in order to achieve a long-run high level of employment. The pursuance of this objective, clearly, is a paramount principle of equity, associated with growth. And, without it, the welfare state is unsustainable.

The second section on 'Revisiting the values' deals with the contradictions, apparent or real, between the current theories of justice and the results in experimental economics, exploring the relevance of strategic voting for well-being, the role of religious parties in public economics and the public economics of the integration of minorities.

Manfred Holler and Martin Leroch compare Rawls' theory of justice, Binmore's evolutionary approach to the norms and Harsanyi's version of utilitarianism with the results of ultimatum game experiments, in which one player offers to the other a given division of the prize with the only answer available being 'yes' or 'no'. If the other refuses, no one gets the prize. In a purely utilitarian approach the second player should accept the offer because the opposite behavior worsens her position. Thus the first player, rationally, should offer to the second player a minimum share. Normally, however, in the experiments, she offers a share of between 30 and 10 percent. It is often argued that this behavior demonstrates the practical relevance of the value of fairness. Holler and Leroch explain these results with the theory of strategic game: the first player, displaying strategic behaviour, takes account of envy and other motivations of the second player. Results differ when the agents are assumed to know the other agents' preferences or decide behind a 'thick' veil of ignorance. Rawls

maintains that his maximin principle of justice is rational under the veil of ignorance. In the ultimatum games, when the first player knows both his situations and that of the other, a maximin solution dominates. This happens because the first player assigns a role to envy in the counterpart choices, with an uncertain weight. In addition, the sentiment of justice may enter into the choices either as a value or as an accepted social norm.

Francesca Acacia and Maria Cubel Sanchez extend the research on happiness and spatial theory of voting by exploring whether the ideological vote affects the level of subjective well-being in society. They base their analysis on the data on the subjective life satisfaction measures of a large sample of individuals over 50 elections in 15 OECD countries. The results support the dominant role of the ideological vote in the well-being of the individuals. Specifically, subjective life satisfaction is negatively affected when electors adopt strategic voting. The results also suggest that the level of well-being is lower when the citizen votes strategically for a political party that does not win the electoral competition. Moreover, political affiliations do matter. Right-wing voters are more susceptible to ideological considerations than left-wing voters. In this chapter, based on empirical testing, ideologies as values do matter per se because their satisfaction adds to subjective well-being, while in the Holler and Leroch chapter on ultimatum games and the theories of justice the results reached in the experiments could also be interpreted in utilitarian terms.

Dennis Mueller's chapter analyzes, in a public choice approach, the rationale underlying the creation of religious parties, arguing that they may pose challenges and dangers for democratic institutions. As Mancur Olson (1965) stressed, forming an effective interest group can be difficult, because individuals with common interests have an incentive to free ride on other members of the group, since lobbying activities cost time and money. Thus, some groups are better at organizing themselves and influencing the actions of the State than others. Religious parties, because of their faith and organization, may be, therefore, powerful interest groups. These parties can behave like any other party in shaping the basket of public goods that the State provides to match the preferences of their supporters, and in securing – by rent-seeking activities – tax breaks and subsidies for their organizations. Religious parties differ from most other parties, however, as they may seek legislation banning certain actions that are prohibited by the religions they represent, thus imposing costs on members of the community who do not belong to these religions, or are less fervent in their religious beliefs. Thus they may seek to restrict individual freedoms. Evidence that this is the case is presented in theoretical terms and with a brief overview of the histories of religious parties in Europe and Israel. The chapter also deals with the dangers of polarization in the US by the

transformation of the Republican Party into a religious party and on the problems created by the Islamic parties in the 'Arab springs' affecting many countries in Africa and the Near Middle East. Democracy is new to the Middle East and one must not be too quick to judge it a failure or to criticize the Islamic parties. They may learn to be more tolerant of others, or be forced to be so by future electoral outcomes. But they may not. Recent events in the Middle East suggest that the successful revolutionaries may have merely replaced one form of tyranny with another. In a public choice approach to public economics, replacement of democracy by tyranny is obviously extremely relevant.

Nils Goldschmidt and André Habisch in their chapter deal with Western religions, social ethics and public economics within an institutional interdisciplinary approach. They argue that – contrary to what is often held to be true – the relation between Western religions and public economics should not be perceived as conflicting. Rather, both have mutually enriched one another in many varied ways. Attempting to explain religious types of behavior and theological positions by using an incentive-based economic theory of religion is not very fruitful, in that, crucially, this approach is unable to capture the intrinsic motivation and the free self-determination of humankind stemming from religious conviction. The great changes brought about by industrialization in modern, Western societies revolutionized not only economic theory but theological thinking about society as well. The phases of adaptation and reflection experienced by these disciplines were linked to numerous controversies and debates both within and between the two disciplines. Ordoliberalism and the related social market economy that has influenced the European Institutions and the principles of the European Monetary Union have a link with Christian ethics. With Pope Benedict's encyclical 'Caritas in Veritate', religious tradition can provide relevant impulses to enrich the paradigmatic development of Ordoliberalism and public economics. In our living environment, religions remain as 'living fossils', being phenomena of modern society with their roots in times of a pre-modern culture, in a world marked by agrarian production, small and personal communities and comprehensible environments. Their problem is how their long-held values can be transposed to a global, individualistic and constantly changing world.

Public economics of religious parties (and the complexity of this concept) deserve much more attention by the economists than they have received up to now, and Mueller's chapter, with its public choice approach, offers a fruitful methodological point of view. Goldschmidt and Habisch's chapter, in terms of economics of ethics, offers another one.

The concluding chapter of the section by Bengt-Arne Wickström deals with the public economics of diversities in a theoretical welfare econom-

ics cost-benefit analysis framework. Religions here are considered, in the theme of granting equal rights, in a public choice-club approach. Other main factors that matter for the issue of the integration of the minorities with the majorities are diversities of language and/or of ethnic origin. The presence of ‘minorities’ with these diversities in a state as club, may be due to the change of geographical boundaries and the creation of minority status for a population that has remained in the same places in which it formerly was the majority. Minorities may also be derive from new migrations from less developed to more developed countries. Static and dynamic cost-benefit analysis may be made – from the point of view of the minorities and of the majorities – for the extension rights, under concave cost structure, with and without externalities. The choices may be described using a decision tree: the potential immigrant chooses to leave her home country or stay. If leaving, she has to decide to accept or resist integration. If resisting, the children may be subject to forced integration or the government as club may remain passive or provide the minority with autonomous rights. Preferences for variety and language ecology, in a dynamic model with overlapping generations, may favor more extension of rights than in the static model.

The third section titled ‘Beyond “rationalistic” rational choices’ provides a new view on rational choices considering the neglected role of memory and deals with the relevance of group motivations on individual rationality and with the effects of media on the information by which individual and collective choices are made.

It opens with a chapter by Michele Caputo on a mathematical model of the memory in the behavior of individuals and the markets affected by extreme events. The chapter discusses and quantifies the oscillatory reactions to events of choices done with a *memory-damped accelerator* due to the accumulation of the apperception of successive negative effects of that event. Cycles are thus derived in behavior after extreme events. Caputo shows the existence of such cycles, for instance in the number of people returning to their homes after a flood, the reduction in passenger flights after a terrorist attack, the number of abortions following a law legalizing them and the number of crimes of corruption and theft after intensive campaigns against them by the police and courts. The return to normality has similar features of oscillation with decreasing amplitude. The mathematical memory paradigm may be shaped with the fractional derivative introduced by Caputo (1967). More generally, for Caputo fractional derivatives are an important tool of analysis for the theory of rational expectations based on the information collected by individuals through the memory of past events. Cyclical behaviors and resistance to adapt to new social situations may be explained by the gradual fading of memory.

The chapter by James Alm, 'Expanding the theory of tax compliance from individual to group motivations', questions the validity of the standard theory of rational individual behavior, arguing that taxpayers' decisions may appear irrational because very often the tax compliance is higher than the standard models of tax evasion would predict. He explains the apparent paradox by what he calls the *social interactions theory of behavioral economics*, that is, individual choices based on group motivation rather than on (mere) individual motivation. Individuals may pay taxes as the price of public services because they believe that this is necessary to induce others to contribute. Their behavior then may be brought back to self-interest rationality when voluntary cooperation emerges as the dominant individual strategy in the group to overcome the 'prisoner's dilemma' trap. In addition, individuals are influenced by the social context in which decisions are made by group motivations related to social (or group) norms, social capital, social customs, social networks, fairness, trust, reciprocity, intrinsic motivation, or tax morale, as well as by individual notions of guilt, shame, morality or altruism. The chapter gives ample empirical and experimental evidence of the relevance of this brand of behavioral economics on the individual choice as shown in tax compliance. The results have obvious implications for other individual choices relevant to public economics.

This chapter provides empirical evidence, as with tax compliance, of the relevance of social norms, that in Holler and Leroch's chapter, was one of the possible reasons why, in the ultimatum game, results deviate from a utilitarian individualistic solution.

Francesco Sobbrío's chapter, 'The political economy of news media: theory, evidence and open issues', explores the literature on the effects of media on public choice to assess if these effects exist, if media bias exists, and if so, why and what type of bias, as well as, finally, looking at the extent to which this bias affects public policy choices. The efficiency of the democratic process of public economy ultimately depends on whether the changes in the political class caused by the changes in the electoral choices are also translated into changes in the supply of public goods. The impact of news media on electoral politics and on the selection of elected politicians is thus paramount to test the rationality of the process. Bias from news media may arise on the supply side by selective omission of information, issues selection and agenda setting as well as by 'framing', that is, by information which distorts the knowledge by focusing on a subset of the relevant aspects of the considered situation or issue. On the demand side bias may derive from slanted endogenous information acquisition due to the costs of acquiring information and to the opportunistic behaviors of the journalists. The bias of information arising on the supply



side may be caused by the ideological bias of journalists and by incumbent government, politicians, lobbies and advertisers putting pressure on media. The review evidences the relevance of distortions in the market for news and the related implications for the public policy outcomes. It also presents the policy issues regarding the scope for public intervention in the market for news in the light of the new Internet information age. Obviously one implication of this chapter is that, as well as the media, public policy may also be distorted by the influence of the biased news media on the process of choice.

The themes of this chapter will re-emerge in three of the five chapters of the fourth section on optimal government and government failure. Indeed, the section deals with unconventional theoretical tools relating to the role of information, in public choices, inadequately considered as yardstick competition among governments, and cognitive dissonance in relation to government size and rent seeking. It also deals with the theme of the optimal composition of current and capital expenditure within governments of a size substantially smaller than the prevailing ones in the developed economies. It also presents the alternative methodological historical perspective for judging government performances in government interventions in the market via regulations.

Pierre Salmon in his chapter, 'How significant is yardstick competition among governments? Three reasons to dig deeper', argues that even if now the significance of yardstick competition among governments is confirmed as for fiscal variables in a fiscal federalism context, its significance is much broader and deeper than in the current stream of research. Its relevance must be sought without limitation to fully observable relations and processes. It may be applied beyond the fiscal variables to laws and regulations, macro and micro variables such as growth, inflation, unemployment, level of education. A distinction may be drawn between variables that are mainly policy outcome, such as professional skills acquired in the schools, and those that are mainly policy instruments, such as expenditures for education. Latent yardstick competition, that is, the anticipation of yardstick voting, induces officeholders to set bounds to their decisions, considering the magnitude of the loss in electoral support that a negative gap would generate compared with the level of voters' support loss that they would judge intolerable. Furthermore, yardstick competition may have hidden influence, as in the choice of the allocation of governments' resources put to discretionary uses. Yardstick competition should also be adopted in the context of states' memberships of looser unions or independence. Salmon's chapter may also stimulate reflections on the institutionalization of yardstick competition among governments by official information on standard costs, the costs of the best performing region and related performances

indicators. Are the parameters employed by the European Commission and the International Institutions in assessing the behavior of the object of countries' interventions meaningful from a yardstick competition perspective?

The purpose of Forte and Magazzino's chapter on 'Optimal size of governments and the optimal ratio between current and capital expenditure' is to analyze jointly two parameters that are often conflicting in relation to the policies of fiscal consolidation for the countries with large public deficits and/or public debt crisis: that of the optimal size of public spending and that of the size of the optimal size of capital expenditure. It was shown by the two authors in a previous article (Forte and Magazzino, 2011) that the optimal size of governments in the developed OECD countries ranges around 38–40 percent of GDP and that a reduction in public expenditure higher than this level could bring about an improvement in the rate of economic growth, also achieving a better ratio of debt to GDP. In this framework, one is faced with the question of whether a fiscal consolidation policy should reduce current and capital expenditures or rather increase capital expenditure while additionally reducing the current one. The results obtain by the econometric research on 30 European countries in the 1970–2011 period do show that while the size of current expenditure, from the point of view of GDP maximization, is much greater than that for the optimal size of government (38–40% of GDP), the optimal level of capital expenditure is much greater and consistent with the optimal size of total expenditure previously found. In addition, results do not change substantially for the optimal level of capital expenditures for countries with higher versus lower capital expenditure, with a higher versus lower ratio of debt to GDP, and with the constraint of a common currency (the euro) versus the constraint of their own currency. While the results of the chapter are coherent with those of Fedeli and Forte on deficit and tax burden and employment, it remains to be explored to what extent the capital expenditures by governments that are linked with economic growth need to be activated by the government funding or by private finance as with Public and Private Partnerships and with the Private Finance Initiative.

Mark Casson's chapter, 'Government failures in railway public policy: the British case', shows that the pursuance of competition by parliaments, governments and agencies of regulation, as with network industries, may obtain results, from the point of view of the consumers' interests, opposite to those intended. This has been the case for the UK's railways system. The parliament was highly relevant in shaping the network, where it was exposed to the pressures of various regional and business interests, with the Board of Control of railways having more relevant influence over their operation. While it opposed large mergers, it favored schemes promoted

by established companies over those of independent companies, because integrated ownership would facilitate good connections. This, however, indirectly stifled competition. Parliament attempted – unsuccessfully – to correct for this policy. An important lesson from this historical experience is that competition can be bad for network industries unless the owners and operators of individual linkages are obliged to cooperate with customers who wish to combine the services of one part of the network with those of another. The tendency for a company to obstruct a customer's use of a rival portion of the network is strongest with a few firms, each operating an integrated network. Railways are unusual (though not unique) in that they require substantial infrastructure, not only at terminals, but also for linkages. Because of this, the limitations of competition on them does not have direct analogues in all other network industries. Nevertheless, there is sufficient similarity to suggest that artificial impediments to 'picking and mixing' may be common in network industries. Because competition encourages the creation of such impediments, strengthening it may not have the beneficial consequences that ideological considerations may suggest. One may add that the historical analysis of the effect of regulations on the structure of the economy may shed new light on this part of the theory of the economics of the public sectors.

Gordon Brady's chapter, 'Cognitive dissonance, iron triangle and rent seeking: sequester and the fiscal cliff' and the following chapter by Francesco Forte and Michela Mantovani, 'Cognitive dissonance, efficient and inefficient rent seeking and public aid to the movies', dealing with the role of cognitive dissonance in relation to rent seeking, revisit some under-considered contributions of Gordon Tullock that interact with the issues dealt with in Sobbrío's chapter on the role of media in shaping information. Cognitive dissonance was introduced in theoretical economics by Akerlof and Dickens (1982) to reconcile the paradigm of individual utility maximization with that of the maximization of cognitive consistence, in order to show how – with their choices in public economy – individuals may remedy market choices which appear to them dissonant with their 'true' will. The two chapters presented here show that actually cognitive dissonance may work the other way and may foster excessive public spending and rent seeking. Gordon Brady connects his article to Tullock (1971) who employed the paradigm of cognitive dissonance to explain why people vote for income redistribution to the poor instead of aiding them through charity. Aid to the poor satisfies the altruistic sentiment of solidarity arising from information on the needy but conflicts with self-interest. To resolve the dissonance, people vote for redistribution, knowing that their loss of utility would be smaller because others too are forced to contribute, even if unwilling. Brady applies the cognitive dissonance paradigm to the

case of the automatic cuts in public spending introduced to reduce the budget deficit in the US, policies dramatically termed ‘sequestering’ and the ‘fiscal cliff’. The chapter examines the manipulation of beliefs due to the new information caused by false or misleading narratives, circulated to modify the choices of the citizens-taxpayers to preserve public spending from the cuts required to re-equilibrate the budget. The ‘iron triangle’ of politicians, bureaucracy and pressure groups guided by mutual interest, may foment and quell imaginary dissonance with *general interests* that electors consider as priorities to maximize their *own self-interest*. This kind of cognitive dissonance, which may be brought back to the theory of fiscal illusions and to the conceptual frame of Pareto derivations and residuals, provides a useful framework for examining a less considered aspect of rent seeking, that of preservation of the rents obtained.

Forte and Mantovani in their chapter, ‘Cognitive dissonance, efficient and inefficient rent seeking and public aid to the movies’, test the cognitive dissonance principle and extend Tullock’s theory of efficient rent seeking by looking at aid given to movies in Italy, in the European context. In Europe movies are aided under the French principle of ‘cultural exception’ adopted to preserve the ‘cultural identities’ of the various regions of the European union from the predominance of ‘American mass culture’. There seems to be an inconsistency between the choices of individuals as consumers in the market where they prefer the movies of the ‘mass culture’ and in their choices as electors, when the majority of them agrees to aid Italian movies because they are insufficiently preferred by free market choices. Cognitive dissonance theory may dissolve the contradiction: a majority of electors may feel discomfort in knowing that their preferences about movies run contrary to the high values that they should pursue and pay for this by sharing the burden with the minority. Gordon Tullock in his seminal paper on rent seeking on the welfare implication of tariffs, monopolies and theft of 1967, introduced the dichotomy of efficient and inefficient rent seeking. If there is competition among the rent seekers the costs incurred in may reduce the rent of the winners to zero. The result may be defined as efficient because it does not leave any surplus, but consumers still pay the rent. The aid to movies may be given in the form of subsidies by discretionary bureaucratic choices or through an automatic market selection by tax exemptions. Furthermore, it may be given in connections with advertising, that is, by a quasi-market practice. In the last two cases Tullock’s competitive rent seeking may become ‘efficient’ in a proper sense, because the results obtained conform to the end pursued, while in the first case the rent seeking may be inefficient in this narrow sense because the end pursued by the public intervention is not obtained. The aid to movies by the Fund for the Performing Arts (FUS) was a failure both from the broad

point of view of the cultural exception and from that of promoting culturally qualified movies to the public. Tax credits and local aid to encourage the localization of movies in promoting local tourism and local products have been much more efficient from the point of view of the revival of the Italian movie industry. And the latter policy has been efficient also from a cultural point of view in the valorization of local cultural sites and landscapes. Product placement may be a market practice that provides benefits to the cultural industry without a cost to the taxpayer. The efficient versus inefficient rent seeking paradigms considered in this chapter might also be applied to rent seeking by entities (including the religious ones) that supply a private provision of public goods such as education, scientific research, charity, health services.

The fifth section dealing with the public economics of public bads includes chapters on the Coase theorem applied to the avoidance of war conflicts, on the rules of maximization of profits from corruption by the public bureaucracies, on the reasons why an informal economy exists as a big phenomenon and how it could be reduced to a small one without forced solutions, and on the exploration of the long and short run criminal cycles for corruption, theft and counterfeiting of various types.

Dario Maimone Ansaldo Patti and Daniel Montolio's chapter, 'Bargaining in international conflicts resolution: UN involvement and conflict settlement', offers a new application of the Coase theorem (Coase, 1960) to the solution of controversies about property rights. For the conflicts between countries involving negotiable property rights there is always a peaceful bargaining Coase solution with a Nash equilibrium. Any attempt of an arbitrator to reach a different result to avoid the war is bound to fail. The implication of the chapter is that the UN as arbitrator, and many other arbitrators that have intervened in avoiding military conflicts, actually have not been able to do so probably because they did not want to apply the Coase solution, or were not enough informed about the gains and losses as the parties involved in the bargain, who know them better than any external well-intentioned entity (this last point is also an argument pertaining to the Coase theorem as pointed out in Forte [2007]). The stylized situation modeled in the article is that of two neighbor countries in dispute over a piece of fertile land. One of the two countries has invested more in military technologies, the other in the technologies of land productivity. The ordinary Coasian pollution costs that are at the basis of the controversy here are replaced by the expected costs of a war. The country with military superiority shall compare the net benefits that may be obtained from the likely victory in the war with the (land) concessions to avoid the war by the likely loser. The costs consist both in military costs and in destruction of investments in fertile land. The country

with superior productivity technology shall compare the concession to be given to the other party with the loss that would be sustained by the war costs plus the losses of land product due to the destructions of war. The country superior in land technologies shall compare the concession in terms of land to the other party to avoid the war with the loss they would undergo through prosecuting a war in which they are likely to be defeated. A Coase peaceful solution with Nash equilibrium shall emerge which is advantageous for both parties, because under the peace there is a surplus in terms of net land product, in comparison with a war solution that implies war costs and damages to property. The surplus may be divided between them, with the Nash rule (or any other rule accepted by the parties) respecting, as a constraint, the amount that the winner may obtain by the war. Logically the arbiter cannot find a solution different from the one which corresponds to the rule of sharing accepted by the parties. Thus the Coase theorem is demonstrated, in the manner of the victim country that stops the potential polluter by paying her at least what she could get by polluting, because this is the best solution for both. An important implication of this chapter is that countries with superior technological knowledge should be ready to share it between productive and defense technologies with a sort of optimal mix to be able to respond to the future menaces of neighbor countries. Knowing this may avoid their war investment – if they are ‘rational players’.

The chapter by Koziashvili, Nitzan and Tobol on ‘The norm of profits extraction from corruption by bureaucracy and market size’ introduces a new law of bureaucracy maximization, in relation to the ‘norms’ of corruption adopted by controlling bureaucracies to extract rents from the controlled business. The chapter begins with the firm’s problem in facing a norm of bureaucracy that may influence its optimal output. If the bureaucrat controls the relationship between the profit share extracted from the producers and the degree of competition, then reduced competition increasing the degree of monopoly increases the profit per unit of production and allows an increased rate of extraction of the producers’ profit. Or, vice versa, increased rate of extraction always leads to less competition. The intuition behind this maximization theorem is that firms that have a bigger profit before the rent extraction because they exploit the consumers may pay a higher share of their profits. The increase in the profits shares extracted by the corruption bribes on the high profit firms overcompensates for the reduction in the number of bribes of firms subject to the extraction. Notice that with a reduced amount of firms which are subject to the controls, the aggregate amount of services offered by the bureaucracy shall be lower than that of the Niskanen model of maximization of bureaucratic expenditure. To maximize their profits

from corruption, bureaucracies must minimize their supply of regulatory services. This chapter, in addition to this insight in bureaucratic behavior, which implies a tendency of the regulators to create monopolies, provides interesting reflections in relation to the Gordon Tullock's efficient competition paradigm. Indeed, if the bureaucracies need to increase the total surplus on which their rent is extracted to maximize their profit extraction, they shall also be interested in restricting the competition among the firms requiring the (monopolistic) privileges insofar as this maximizes their rents extraction.

Giorgio Brosio, Juan Pablo Jiménez and Roberto Zanola in their chapter 'Alternative views on the origins and impact of the informal economy' consider this kind of economy a pathology also from a strict economic point of view, because while it provides employment and income in the immediate term, it reduces growth in the longer term. It jeopardizes the welfare state, one of biggest achievements of the development of the State in rich democracies. Contrary to the current wisdom, the main cause of the persistence and growth of the informal economy, both in developing countries and in the industrial economies, is a system of social protection, based on uniform standards of regulation, service provision and financing modeled on an average level of development and hence of productivity. In part, standards and the deriving uniformity are explained by technical and administrative constraints. In part, they are explained by the working of a political mechanisms based on the strategic voter or by paternalist behavior in less democratic settings. That is, the levels of standards may correspond to the preferences of the strategic voter (such as the median voter), or to the preferences of an elite that is able to decide what is better for the whole population. When uniform standards are set up and implemented everywhere, unless preferences are the same for every citizen they result in a level of service provision that is necessarily too high for some citizens and too low for others, creating welfare losses. However, these losses are not symmetric. Citizens with preferences for higher levels of service provision than those that are publicly provided may address the market, or other providers, such as associations of consumers, or clubs, to satisfy them. This is particularly easy in the case of most social protection policies, there being plenty of private insurers. Adjustment is not feasible for those who have lower preferences than standards, since it is not possible to reduce the levels of publicly provided services once they are provided. Evasion to regulations and shifting activities into non-regulated forms is the reaction to welfare losses. This applies especially to poor individuals, who in general ask for less public goods than rich individuals. Indeed rich people tend to spend more on insurance policies, or save more for their retirement. The right solution does not lie either in the choice of lowering the

general standards or of enforcing their application, which may deteriorate the economic situation of the weakest, but in changing the model so that there are different options. For example, in addition to obligatory social insurance pension schemes and health services there may be optional ones. Also, with reference to safety and security, uniformity of regulation and policies is not always a necessity, or at least uniformity can be debated. This chapter may be connected with that of Wickström on the rights of the minorities, in relation to rights that must be paid with public services and financed by taxation.

The final chapter, by Michele Caputo, Francesco Forte and Michela Mantovani on 'Long-run and shorter-run criminal cycles in the economics of public bads' deals with a new theme of public economics, that of endogenous criminal-business cycles, interconnected with a particular (but not minor) aspect of the shadow economy. Up to now cyclical behaviors in economic criminal activities have been explored in economics only as exogenous phenomena in relation to business cycles. This chapter demonstrates the existence of criminal-business cycles in Italy as endogenous phenomena focusing, for the long run, on corruption in the public economy and on fraud in the market economy. For the shorter run, counterfeiting of goods in general and in its four classes of 'Made in Italy' counterfeiting, brand counterfeiting, fashion brand counterfeiting and violation of health and safety requisites, are analyzed. For the long-run cycles the yearly data of crimes reported to the courts in the last 90 years are employed, with particular reference on those of the last 65 years. For the shorter run cycles a unique data set of the financial police has been utilized with the monthly data for the 20 Italian regions from 2007 to 2010, showing the amount confiscated in the four cases of counterfeiting, the persons indicted and the interventions done. The two twin classes of crimes of corruption and fraud, in the period covering the last 90 years, clearly have long-run cycles autonomous from the business cycles observed in the same timeframe. In the 1945–2010 period the two cycles have a similar profile and duration of variable length and are correlated. The peaks of frauds follow, with a lag, those of corruption cases. These cyclical fluctuations and their correlation may be explained by the interaction between the cyclical behavior in the deterrence policy of the courts and of police and by the cyclical change in the assessment of the risk of being caught. Due to their limited resources, the courts and the police when concentrating their attention and financial skills on corruption cases must reduce their efforts in combating the frauds. Meanwhile, the fraudulent, perceiving that the attention is polarized elsewhere, increase their crimes. When the popularity of combating the crimes of corruption fades because their intensity falls, the attention goes to the frauds whose amount has increased, so that also the popularity



of pursuing them has increased. Meanwhile, the memory of the harshness of the punishments for corruption cases fades and the political class and the public administration officers revert to their corrupt ways. Behind this cyclical behavior, the propensity to commit crimes of corruption and fraud measured on per capita GDP has increased. This upward trend may be explained by the increase of the public sector services, but also by the cumulative effects of the contamination of social habits created by the previous episodes of crime.

Shorter-run endogenous criminal cycles do exist in terms of the amount of goods confiscated as proxy to the amounts dealt with in this shadow economy business, as is the case for the various categories of counterfeiting. These cycles have no correlation with the variable intensity of the controls by the financial police whose strategy pursues more complex objectives. The six-month cycles of brand counterfeiting and of products' Italian origin counterfeiting appear connected with the seasonal peaks of demand for these products, associated with the change of the seasons and the related festivities and waves of tourism. However, there is no correlation among the peaks or troughs of the cycles of these four kinds of counterfeiting. The peaks and troughs continue on the same calendar despite their predictability, in spite of the increased efficiency of the police, probably because they are determined by the firms at the beginning of the chain whose risk of losing a confiscated product is less than the gain derived from the peak demand. The retailers recruited in the informal economy do continuously change. For the counterfeiting of safety and health requisites the five-month cycles seem to be connected to memory factors by the consumers and to the time required to refurnish the supply chain with new counterfeited goods coming from distant countries. Here too there is an increasing trend of such crimes, which contrast with the effectiveness of the interventions of the financial police. The explanation may be found partly in the 'benevolence' of the consumers. Another factor may be the fact that these goods are ersatz goods. In a sense, the long-run cycles examined have to do with superior 'bads', while the short-run ones have to do with inferior goods.

## NOTE

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