

# Public Choice Theory: Why Leaders Act in Self-Interest

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In economics, public choice theory is the use of modern economic tools to study problems that traditionally are in the province of political science. From the perspective of political science, it may be seen as the subset of positive political theory which deals with subjects in which material interests are assumed to predominate.

In particular, it studies the behavior of politicians and government officials as mostly self-interested agents and their interactions in the social system either as such or under alternative constitutional rules. These can be represented a number of ways, including standard constrained utility maximization, game theory, or decision theory. Public choice analysis has roots in positive analysis ("what is") but is often used for normative purposes ("what ought to be"), to identify a problem or suggest how a system could be improved by changes in constitutional rules. Another related field is social choice theory.

### **Origins and formation**

The modern literature in Public Choice began with Duncan Black, who in 1948 identified the underlying concepts of what would become median voter theory. He also wrote *The Theory of Committees and Elections* in 1958. Gordon Tullock refers to him as the "father of public choice theory".

James M. Buchanan and Gordon Tullock coauthored *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962), considered one of the landmark works that founded the discipline of public choice theory. In particular (1962, p. v), the book is about the political organization of a free society. But its method, conceptual apparatus, and analytics "are derived, essentially, from the discipline that has as its subject the economic organization of such a society." The book focuses on positive-economic analysis as to the development of constitutional democracy but in an ethical context of consent. The consent takes the form of a compensation principle like Pareto efficiency for making a policy change and unanimity at least no opposition as a point of departure for social choice.

Kenneth Arrow's *Social Choice and Individual Values* (1951) influenced formulation of the theory. Among other important works are Anthony Downs's *An Economic Theory of Democracy* (1957) and Mancur Olson's *The Logic of Collective Action* (1965).

Public choice theory is commonly associated with George Mason University, where Tullock and Buchanan are currently faculty members. Their early work took place at the University of Virginia and Virginia Polytechnic Institute and State University, hence identification of a Virginia school of political economy.

Development of public choice theory accelerated with the formation of the Public Choice Society in the United States in 1965. The loci of the Society became its journal *Public Choice* and its annual

meetings. The journal and meetings mainly attracted economists and political scientists. The economists brought their choice-based, model-building skill. The political scientists brought their broad knowledge of different political systems and detailed knowledge of institutions and political interaction. Scholars in related fields, such as philosophy, public administration, and sociology, also contributed.

In 1970 the median voter theory was accepted without question in public choice, but by 1980 it had been assaulted on so many fronts that it was almost abandoned. Works by Romer and Rosenthal (1979) and McKelvey (1976) showed that, when political issues are considered multidimensional rather than single dimensional, an agenda setter could start at any point in the issue space and, by strategically selecting issues, end up at any other point in the issue space, so that there is no unique and stable majority rule outcome.

During the same decade, the probabilistic voting theory started to replace the median voter theory, since it clearly showed how it was able to find Nash Equilibria also in multidimensional space. The theory was later completely formalized by Peter Coughlin.

### **Special interests**

Public choice theory is often used to explain how political decision-making results in outcomes that conflict with the preferences of the general public. For example, many advocacy group and pork barrel projects are not the desire of the overall democracy. However, it makes sense for politicians to support these projects. It may make them feel powerful and important. It can also benefit them financially by opening the door to future wealth as lobbyists. The project may be of interest to the politician's local constituency, increasing district votes or campaign contributions. The politician pays little or no cost to gain these benefits, as he is spending public money. Special-interest lobbyists are also behaving rationally. They can gain government favors worth millions or billions for relatively small investments. They face a risk of losing out to their competitors if they don't seek these favors. The taxpayer is also behaving rationally. The cost of defeating any one government give-away is very high, while the benefits to the individual taxpayer are very small. Each citizen pays only a few pennies or a few dollars for any given government favor, while the costs of ending that favor would be many times higher. Everyone involved has rational incentives to do exactly what they're doing, even though the desire of the general constituency is opposite. (It is notable that the political system considered here is very much that of the United States, with "pork" a main aim of individual legislators; in countries such as Britain with strong party systems the issues would differ somewhat.) Costs are diffused, while benefits are concentrated. The voices of vocal minorities with much to gain are heard over those of indifferent majorities with little to lose.

### **Decision making processes and the state**

One way to organize the subject matter studied by Public Choice theorists is to begin with the foundations of the state itself. According to this procedure, the most fundamental subject is the origin of government. Although some work has been done on anarchy, autocracy, revolution, and even war, the bulk of the study in this area has concerned the fundamental problem of collectively choosing constitutional rules. This work assumes a group of individuals who aim to form a government. Then it focuses on the problem of hiring the agents required to carry out government functions agreed upon by the members.

The main questions are: (1) how to hire competent and trustworthy individuals to whom day-to-day decision-making can be delegated and (2) how to set up an effective system of oversight and sanctions for such individuals. To answer these questions it is necessary to assess the effects of creating different loci of power and decision-making within a government; to examine voting and the various means of selecting candidates and choosing winners in elections; to assess various behavioral rules that might be established to influence the behavior of elected and appointed government officials; and to evaluate alternative constitutional and legal rights that could be reserved for citizens, especially rights relating to citizen oversight and the avoidance of harm due to the coercive power of government agents.

These are difficult assessments to make. In practice, most work in the field of Public Choice has dealt with more limited issues. Extensive work has been done on different voting systems and, more generally, on how to transform what voters are assumed to want into a coherent "collective preference". Of some interest has been the discovery that a general collective preference function cannot be derived from even seemingly mild conditions. This is often called Arrow's impossibility theorem. The theorem, an economic generalization of the voting paradox, suggests that voters have no reason to expect that, short of dictatorship, even the best rules for making collective decisions will lead to the kind of consistency attributed to individual choice.

Much work has been done on the loose connection between decisions that we can imagine being made by a full contingent of citizens with zero collective decision-making costs and those made by legislators representing different voting constituencies. Of special concern has been logrolling and other negotiations carried out by legislators in exercising their law-making powers. Important factors in such legislative decisions are political parties and pressure groups. Accordingly, Public Choicers have studied these institutions extensively. The study of how legislatures make decisions and how various constitutional rules can constrain legislative decisions is a major sub-field in Public Choice.

## **Bureaucracy**

Another major sub-field is the study of bureaucracy. The usual model depicts the top bureaucrats as being chosen by the chief executive and legislature, depending on whether the democratic

system is presidential and parliamentary. The typical image of a bureau chief is a person on a fixed salary who is concerned with pleasing those who appointed him. The latter have the power to hire and fire him more or less at will. The bulk of the bureaucrats, however, are civil servants whose jobs and pay are protected by a civil service system against major changes by their appointed bureau chiefs. This image is often compared with that of a business owner whose profit varies with the success of production and sales, who aims to maximize profit, and who can hire and fire employees at will.

### **Rent-seeking**

A field that is closely related to public choice is "rent-seeking". This field combines the study of a market economy with that of government. Thus, one might regard it as a "new political economy." Its basic thesis is that when both a market economy and government are present, government agents are a source of numerous special market privileges. Both the government agents and self-interested market participants seek these privileges in order to partake in the monopoly rent that they provide. When such privileges are granted, they reduce the efficiency of the economic system. In addition, the rent-seekers use resources that could otherwise be used to produce goods that are valued by consumers.

Rent-seeking is broader than Public Choice in that it applies to autocracies as well as democracies and, therefore, is not directly concerned with collective decision-making. However, the obvious pressures it exerts on legislators, executives, bureaucrats, and even judges are factors that public choice theory must account for in its analysis of collective decision-making rules and institutions. Moreover, the members of a collective who are planning a government would be wise to take prospective rent-seeking into account.

### **Political market failure: undemocratic governments**

Public Choice Theory has been developed largely in the context of democratic political systems of the variety that exist in Europe and North America. A pioneering work--and, perhaps, the only work to-date of its kind--seeking to analyze collective decision-making based on rules and institutions that characterize the Less Developed Countries was undertaken by Muzaffar Ali Isani at Georgetown University. It focuses largely on the assumptions of a generation of development economists who have articulated the role of the state or political action as an efficient alternative to 'economic' market failures. Isani has suggested that once we introduce 'political' market imperfections as generally found in these countries, we may be confronted with the possibility that far from correcting market failures, political action may actually prove to be a source of further distortions in the economy. He then goes on to develop an essentially economic paradigm of politics appropriate to many developing countries and which is consistent with the axioms of

economic theory.

## **Perspective**

Prior to the emergence of public choice theory, many economists tended to consider the state as an agent outside the scope of economic theory, whose actions depend on different considerations than those driving economic agents. (The many other economists who did place the state and its agents within such theory include Vilfredo Pareto.)

Public choice theory attempts to look at governments from the perspective of the bureaucrats and politicians who compose them, and makes the assumption that they act based on Budget-maximizing model in a self-interested way for the purpose of maximizing their own economic benefits (e.g. their personal wealth). The theory aims to apply economic analysis (usually decision theory and game theory) to the political decision-making process in order to reveal certain systematic trends towards inefficient government policies. There are also Austrian variants of public choice theory (suggested by Mises, Hayek, Kirzner, Lopez, and Boettke) in which it is assumed that bureaucrats and politicians may be benevolent but have access to limited information. The assumption that such benevolent political agents possess limited information for making decisions often results in conclusions similar to those generated separately by means of the rational self-interest assumptions. Randall Holcombe and Richard E. Wagner have also developed the notion of "Political Entrepreneurship".

## **Claims**

One of the basic claims that results from public choice theory is that good government policies in a democracy are an underprovided public good, because of the rational ignorance of the voters. Each voter is faced with a tiny probability that his vote will change the result of the elections, while gathering the relevant information necessary for a well-informed voting decision requires substantial time and effort. Therefore, the rational decision for each voter is to be generally ignorant of politics and perhaps even abstain from voting. Rational choice theorists claim that this explains the gross ignorance of most citizens in modern democracies as well as low voter turnout. Rational abstention does, however, create the "Paradox of voting" whereby strict costs benefit analysis implies that nobody should vote.

## **Special interests**

While good government tends to be a pure public good for the mass of voters, there may be many advocacy groups that have strong incentives for lobbying the government to implement specific policies that would benefit them, potentially at the expense of the general public. For example,

lobbying by the sugar manufacturers might result in an inefficient subsidy for the production of sugar, either direct or by protectionist measures. The costs of such inefficient policies are dispersed over all citizens, and therefore unnoticeable to each individual. On the other hand, the benefits are shared by a small special-interest group with a strong incentive to perpetuate the policy by further lobbying. Due to rational ignorance, the vast majority of voters will be unaware of the effort; in fact, although voters may be aware of special-interest lobbying efforts, this may merely select for policies which are even harder to evaluate by the general public, rather than improving their overall efficiency. Even if the public were able to evaluate policy proposals effectively, they would find it infeasible to engage in collective action in order to defend their diffuse interest. Therefore, theorists expect that numerous special interests will be able to successfully lobby for various inefficient policies. In public choice theory, such scenarios of inefficient government policies are referred to as government failure -- a term akin to market failure from earlier theoretical welfare economics.

### **"Expressive interests" and democratic irrationality**

Geoffrey Brennan and Loren Lomasky claim that democratic policy is biased to favor "expressive interests" and neglect practical and utilitarian considerations. Brennan and Lomasky differentiate between instrumental interests (any kind of practical benefit, both monetary and non-monetary) and expressive interests (forms of expression like applause). According to Brennan and Lomasky, the voting paradox can be resolved by differentiating between expressive and instrumental interests. While voters have virtually no instrumental incentive to vote, they do have an expressive interest in voting. Since voters vote for expressive reasons, politicians win by targeting the median expressive preferences. Bias in favor of expressive interests means that public policy often ignores important practical considerations. For example, there are instrumental costs to restricting international trade. Yet many people favor protectionism as an expression of nationalism, despite its economic costs.

This argument has led some public choice scholars to claim that politics is plagued by irrationality. In articles published in the *Econ Journal Watch*, economist Bryan Caplan contended that voter choices and government economic decisions are inherently irrational. Caplan's ideas are more fully developed in his book *The Myth of the Rational Voter* (Princeton University Press 2007). In opposition to the arguments put forward by economist Donald Wittman in his *The Myth of Democratic Failure*, Caplan claims that politics is biased in favor of irrational beliefs.

According to Caplan, democracy effectively subsidizes irrational beliefs. Anyone who derives utility from potentially irrational policies (such as protectionism) can receive private benefits while imposing the costs of such beliefs on the general public. Were people to bear the full costs of their "irrational beliefs", they would lobby for them optimally, taking into account both their instrumental consequences and their expressive appeal. Instead, democracy oversupplies policies based on

irrational beliefs. Caplan defines rationality mainly in terms of mainstream price theory, pointing out that mainstream economists tend to oppose protectionism and government regulation more than the general population, and that more educated people are closer to economists on this score, even after controlling for confounding factors such as income, wealth or political affiliation. One criticism is that many economists do not share Caplan's views on the nature of public choice. However, Caplan does have some data to support his position. Economists have, in fact, often been frustrated by public opposition to economic reasoning. As Sam Peltzman puts it "Economists know what steps would improve the efficiency of HSE regulation, and they have not been bashful advocates of them. These steps include substituting markets in property rights, such as emission rights, for command and control. . . . The real problem lies deeper than any lack of reform proposals or failure to press them. It is our inability to understand their lack of political appeal" (George Stigler's Contribution to the Economic Analysis of Regulation" 101 J. Pol. Econ. 818, 830 (October 1993)).

### **Rent-seeking**

Another major claim is that much of political activity is a form of rent-seeking which wastes resources. Gordon Tullock, Jagdish Bhagwati, and Anne Osborn Krueger have argued that rent-seeking has caused considerable waste. In a parallel line of research Fred McChesney claims that rent extraction causes considerable waste, especially in the developing world. As the term implies, rent extraction happens when officials use threats to extort payments from private parties.

### **Political stance**

From such results it is sometimes asserted that public choice theory has an anti-state tilt. But there is ideological diversity among public choice theorists. Mancur Olson for example was an advocate of a strong state and instead opposed political interest group lobbying. More generally, James Buchanan has suggested that public choice theory be interpreted as "politics without romance," a critical approach to a pervasive earlier notion of idealized politics set against market failure. As such it is more a correction of the earlier scientific record, almost requiring a certain pragmatism in comparing alternative politicized institutional structures.

### **Remedies for the public choice problem**

Many proposals have been advanced for reducing what is often seen as excessive or improper influence on public choices by those who invest most to influence them. From game theory we have the insight that a winning strategy in competitive games should have a random component so that the opponent can't anticipate one's moves. This is confirmed by the historical resort to having decisions made by officials selected at random, perhaps with a complex process of intermediate

qualifying steps, called sortition. That is what is done in countries using a trial jury selected at random.

### **Applications and wider recognition**

Public choice's application to government regulation was developed by George Stigler (1971) and Sam Peltzman (1976). William Niskanen is generally considered the founder of Public Choice literature on the bureaucracy.

Several notable Public Choice scholars have been awarded the Nobel Prize in Economics, including James M. Buchanan (1986), George Stigler (1982), and Gary Becker (1992). In addition, Vernon Smith (2002) and Elinor Ostrom (2009) were former Presidents of the Public Choice Society.

### **Criticism**

In their 1994 book *Pathologies of Rational Choice Theory*, political scientists Donald P. Green and Ian Shapiro argue that rational choice theory (of which public choice theory is a branch) has contributed less to the field than its popularity suggests. They write:

The discrepancy between the faith that practitioners place in rational choice theory and its failure to deliver empirically warrants closer inspection of rational choice theorizing as a scientific enterprise.

Linda McQuaig writes in *All You Can Eat*:

The absurdity of public-choice theory is captured by Nobel Prize-winning economist Amartya Sen in the following little scenario: Can you direct me to the railway station? asks the stranger. Certainly," says the local, pointing in the opposite direction, towards the post office, "and would you post this letter for me on your way? Certainly," says the stranger, resolving to open it to see if it contains anything worth stealing.

It should be noted that scenarios of this type contain an implicit assumption of zero probability of the two strangers ever interacting again. With a positive probability of future interactions and the propensity of humans to use tit-for-tat type strategies (someone harms or helps you, you return the favor in kind), the optimal totally self-interested decision may be to point to the train station. Furthermore, as David D. Friedman observes, the benefit of cheating the stranger on one occasion may not be worth the mental effort of conceiving a way to do so and weighing the odds of suffering the consequences.

(Sen, in fact, has participated in the development of public choice theory, in such works as *Collective Choice and Social Welfare*.)

James Buchanan and Gordon Tullock outline the limitations of their methodology:

"even if the model proves to be useful in explaining an important element of politics, it does not imply that all individuals act in accordance with the behavioral assumption made or that any one individual acts in this way at all times... the theory of collective choice can explain only some undetermined fraction of collective action. However, so long as some part of all individual behavior... is, in fact, motivated by utility maximization, and so long as the identification of the individual with the group does not extend to the point of making all individual utility functions identical, an economic-individualist model of political activity should be of some positive worth."

(Calculus of Consent, page 29)

Public Choice theorists have been criticized for failure to explain human actions motivated by non-rational or non-economic considerations. They respond, however, that the theory explains a broad variety of actions since humanitarian or even a madman's actions are also rational. This way, the argument goes, public choice allows to account for a much broader variety of actions than any other approach, and in the example above, Sen's rational actors may or may not act in a way he identified, since public choice approach does not mean the actors necessarily take advantage of one another; it only implies that the actions are 'rational'. Action to direct someone to a train station would thus be just as rational as the action to direct the stranger away for one's own reasons. Furthermore, only 'rationalism' helps to explain human motivation, whereas any other approaches such as humanitarian considerations or the willingness to get extra profit (which is in no way the same as 'rational action') would only explain a part of the developments and fails to present a comprehensive picture. Also, Bryan Caplan argues against rationality in politics, and Brennan and Lomasky account for expressive (non-economic) motives in politics.

Schram and Caterino (2006) contains a fundamental methodological criticism of public choice theory for promoting the view that the natural science model is the only appropriate methodology in social science and that political science should follow this model, with its emphasis on quantification and mathematization. Schram and Caterino argue instead for methodological pluralism.