

Elections as Take-Over Bids:
Some Agonistics Concerning Good Government

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ABSTRACT

Agency theory has been widely applied to the governance of business corporations, and to good advantage. The formal framework of agency theory pertains as well to politics, wherein citizens are the principals and politicians the agents. Where take-over efforts occur irregularly for corporations, they occur at regular intervals through elections for politics. Timothy Besley's *Principled Agents* uses agency theory to argue that electoral competition will generally select competent and public spirited politicians. This claim follows from his formal framework, but that framework ignores some questionable and unsettled matters that challenge Besley's relatively roseate view of the qualitative character of electoral selection.

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Politics is a form of commercial activity that attracts significant numbers of people and capital. That activity, moreover, is not confined to parliamentary assemblies and executive offices, for it also extends to such ancillary political enterprises as public relations firms and media outlets. The division of labor in society incorporates political activity. There is good reason to think that people will pursue their comparative advantages in deploying talent and capital across all activities in society. There is also good reason to think that among any cohort of people, those who are most talented and energetic will rise the highest in their chosen fields of activity.

Timothy Besley's (2006) treatment of political selection within the framework of agency theory provides one cogent gloss on this situation. He argues quite reasonably that electoral competition tends to promote the selection of competent politicians. Whatever it is that politicians do, those who are better at it will have more success at it. This claim is surely unexceptional, but Besley doesn't want to stop with that positive claim. He wants also to make a normative claim about the goodness of the subject of that competence. We can readily agree that elections attract and select people who are relatively good at running for office: people who are better at politics will tend to have greater electoral success. Whether this also selects for the disinterested public spiritedness that Besley wants to claim on behalf of elections is a different matter.

While I think Besley has taken some nice steps in advancing these topics, I also think there are missing steps that would have to be supplied before it could be concluded that our present political class now constitutes a new form of natural aristocracy, especially when covered with the ennobling veneer that Besley seeks to provide. What appears to be public spirited within the framework of Besley's analysis might be an artifact of that framework. An alternative framework could find the political class populated with significant numbers of knaves and charlatans, even though still populated by people who are particularly good at what they do.

Agency Theory and Corporate Calculation

An agent uses capital supplied by a principal to act on behalf of the principal. If this relationship works well, the agent will duplicate what the principal would have done had he been able to do the job himself. If it works imperfectly, the agent will convert some of the principal's wealth to his own account through inadequate performance: this conversion could flow directly into the principal's account through excessive charges for the quality of the service supplied; alternatively, it could accrue indirectly through wastage attributable to shirking.

The agency relationship has potential perils, as set forth by Berle and Means (1933) in their description of the separation between ownership and control in corporations. There are, however, a variety of socially-generated protections that limit the real force of this nominal separation. Indeed, the very ability of corporate bodies to survive and thrive suggests strong limits on the real

force of this nominal separation. Most significantly, corporate managers must attract capital, they can't conscript it. Agents must attract business from principals and principals can hire and fire agents at will.

The canonical model of agency pertains to corporate bodies where investors entrust their capital to a manager. There is scope for a manager to convert investor wealth to his own account, but there are also several sources of protection that operate as well, as illustrated by competition for corporate control (Meckling and Jensen 1976) and the future implications of present manager performance (Fama 1980). A reasonable summary of this literature would conclude that agents are tethered to the service of principals, though the tethering device has elasticity (whether it might be somehow optimally elastic is inconclusive). What is of particular significance is that all of the various tethering devices and practices operate through the presence of transferable ownership in corporations. The quality of present management is summarized in the market value of the firm. A managerial challenger's claim to be able to operate the firm more efficiently can be summarized by an hypothesized alternative value for the firm.

A corporation might have one million shares each presently valued at \$100. There is no way to obtain certain knowledge as to whether this observed value reflects efficient managerial deployment of corporate assets; however, transferable ownership provides a framework for economic calculation that facilitates the creation and testing of hypotheses about managerial performance. A claim that incumbent management is inefficient implies that corporate value

could be higher than what is presently observed, and with that gap in value indicating the degree of managerial inefficiency. Transferable ownership makes possible the use of a simple metric for gauging the quality of corporate management.

A challenger's objection to incumbent management would typically be represented by an alternative programmatic structure for the corporation. For instance, a challenger might propose to spin off some operations, acquire some new ones, reorganize some offices, and undertake some new activities. Projections can be formed regarding the impact of this alternative managerial program on the value of the firm. Suppose this projection calls for a firm value of \$130 million, which in turn leads the incumbent to tender an offer for shares at \$120, subject to the acquisition of at least 700,000 shares.

The challenger proposes alternative corporate policy and is able to reduce the numerous features of those policy differences to a simple scalar. It is easy for shareholders to evaluate the incumbent relative to the challenger, for all they have to do is decide whether they want to keep their shares or sell them for \$120; they don't need to pursue the details of the incumbent's business plan. The challenger, moreover, has strong reason to be realistic in forming projections because he is the residual claimant to the accuracy of his projections. Rectitude is a blessing that pays in this setting.

Instead of tending an offer for shares, the challenger might simply campaign on behalf of an alternative slate of corporate directors. This situation starts to resemble the situation with political elections. The challenger still claims

that present management is inefficient, only he is no longer willing to bet on the accuracy of his claim. It's understandable that such claims are discounted by the cheapness of ordinary talk, though even in this case it is plausible to think that shareholders would agree that higher corporate value is superior to lower corporate value (De Angelo 1981)(Mankowksi 1983). Takeovers are rare in the corporate setting, and there is good reason to think that processes of managerial selection work well in securing high-quality managers.

The Institutional Framework for Political Calculation

The corporate setting provides a benchmark for the application of agency theory to politics. Governments are corporate bodies; indeed, cities are described as municipal corporations. As a formal matter, agency theory is capable of encompassing both types of corporate setting. In both settings, capital is obtained from a broad public and is entrusted to a small set of managers. Managerial performance, moreover, is a quality that can vary with the institutional framework by which agents are selected and within which they subsequently operate. As a substantive matter, the agency relationship differs in a number of respects across the two settings. The most prominent institutional difference is surely the absence of transferable ownership within political corporations, though other significant differences are also in play.

To be sure, something resembling transferable ownership results when local governments are financed by property taxes. In this setting, the ownership of housing is tied to the ownership of local government, with the value of local

government reflected in the value of housing. Conversion of wealth by agents can in principle be calculated through the housing market, rendering municipal corporations some form of cousin to business corporations, as explained in Wagner (1986)(1988). Besley, however, works in terms of a model of an isolated state, so no semblance of transferable ownership can come into play to facilitate economic calculation.

An election is an arrangement that calls for the formal submission of take-over bids. The absence of a market for ownership shares in political corporations means that competing claims about managerial competence cannot be reduced to a common dimension through monetary calculation. Where corporate campaigns are centered on projections of corporate value, political campaigns are spread across the various attributes of policy that would have fed into corporate value in the presence of transferable ownership. Vectors of programmatic characteristics will not be reducible to a scalar measure of value. Political campaigns reside in the cheap talk world, as no equivalent to a tender offer is advanced. Tender offers would seem to have rectitude on their side, due to the residual claimant position of those who proffer such offers. With political forms of take-over bid being limited to cheap talk, we should surely expect some movement away from rectitude toward verisimilitude or even mendacity to result because those who advance claims are never placed in the position of betting on those claims.

The very notion of a principal carries an ambiguity in politics that it does not have in commerce. Transferable ownership creates unanimity among

shareholders regarding actions that influence corporate value. This feature does not operate so strongly in politics because there can be divisions among principals that are represented by wealth transfers among principals. An agent might be judged positively by some principals and negatively by others, and for reasons that have nothing to do with some aggregate or general value and everything to do with being in the winning or losing end of redistributions of value. Principals need no longer speak with the same voice because they no longer share in the value consequences of corporate choices according to their shareholdings.

Suppose hotel management is deliberating whether to eliminate some rooms to provide daycare facilities for employees and guests (this illustration is based on Wagner 2007, pp. 108-10). Both managers and shareholders may well hold different appraisals of the commercial consequence of this decision; nonetheless, they will share in the commercial result of that decision and have good reason to be soberly realistic in their judgments and appraisals. The situation changes when the setting is shifted to a political body. There will never be any firm value against which competing claims could be potentially tested, so people can appraise the choice based on their conjectures about the consequences to them.

This replacement of substantive with formal agency seems likely to produced some diminution of rectitude in personal and public expression (Kuran 1995). With substantive agency, people may honestly and openly hold different conjectures about the future value consequences of present actions. In this

setting, people can engage in an open process of conjecture and refutation (Popper 1962) as best they can, realizing always the inescapable difficulty involved in seeking to compare some past experience with some future that is created as an act of imagination. Where some might think the conversion of some rooms to a daycare facility might increase the value of the enterprise, others can honestly hold the opposite conjecture. Regardless of the particular conjecture held, the value of the enterprise provides a focal point around which the discussion can be organized, as well as providing some subsequent test of past conjectures.

When substantive agency is replaced by purely formal agency, the scope for honest and truthful deliberation would seem to narrow. No one will advocate support for converting rooms to daycare because they will secure personal gain that exceeds their share of the fall in the aggregate value of the enterprise. To be sure, there is no aggregate value of the enterprise because there is no transferable ownership. That aside, the speaker would doubtless seek to camouflage such recognition by speaking in terms of some generalized or aggregate interest that cannot be put to any test, other than an acceptance or rejection of the proposal, which is not the same thing.

In the absence of substantive agency, participants become involved in a dialog of discourse that easily can become dishonest and fraudulent, or at least self-deceptive (Cowen 2005). With respect to Pareto's (1935) formulation, the gap between derivations (which were the public rationalizations people advanced

to explain their actions) and residues (which were the foundational sentiments that informed action) would surely widen.

In Summation

The theory of agency provides a useful framework for exploring democratically organized polities. Political practice, like medical practice, academic practice, or any other form of practice, tends to select among entrants according to how well they practice their craft. Successful democratic politicians tend to be good at doing things that return support when elections are at hand. Takeovers are rare in the corporate world, and it's surely plausible to claim that this rarity attests to the generally high-quality of corporate management. While democratic polities provide regular opportunities for the submission of take-over bids, the success rate of challengers is quite low. Successful politicians, like successful corporate managers, are good at what they do. In Besley's formal framework this means that agent quality is about as high as it could be and government about as good as it could get. In the alternative substantive framework that I have sketched briefly, one may see the wisdom in Besley's claim without embracing his yearning for aristocracy.

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