Book Review

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Kemp, S.: *Public Goods and Private Wants. A Psychological Approach to Government Spending.* IX, 196 pp. Edward Elgar, Cheltenham, UK/ Northampton, MA, 2002. Hardcover £ 49.95.

What is the value of publicly provided goods and services? This is the main theme of Simon Kemp's *Public Goods and Private Wants*. It is definitively not the costs that show up in the national accounts. Kemp comes up with a long list of different ways of valuing government services. His focus is on psychological measurement techniques that follow a subjective approach and have often been developed for other uses in psychology. He suggests that psychophysical measures be more often used in economics and offers his own findings and validation results for value ratings on public services conducted in New Zealand and Germany.

The book offers a broad perspective on the measurement of preferences for public goods. A large part of the book reviews various approaches and supplements them with critical assessments from the perspective of a social scientist trained in psychology. The book starts from scratch with a discussion of the concept of utility in economics, economic reasons for government intervention and a short discussion of behavioral measures for inferring the utility of government services (albeit not mentioning voting with one's feet in a federal system). Chapter 3 summarizes the traditional economic approach to understanding government's fiscal behavior: the median voter model. It also gives a brief review of its critique. However, the criticism could be even more severe, as the median voter approach completely neglects democratic institutions beyond what is formulated in the very restrictive assumptions of the model. Subjective measures of value, in the sense that they are not based on revealed behavior but often on verbal reporting, are presented in chaps. 4 and 5. First, introspective measurement that aims at a global assessment is evaluated. There is a long tradition of quality of life measures, in particular in health research, where the focus is on quality-adjusted life years (QALY), but there is now an increasing interest in economics in overall reports of people's subjective well-being. Kemp lists the problems with these measures, e.g. that the underlying scale is not known, that answers might be context dependent, or that ratings can mean different things to different people. In addition to these issues of cardinality and interpersonal comparability, he argues that global measures of well-being are not sensitive enough to measure how people are affected by the provision of government goods. However, they offer the important advantage that people do not have to evaluate government services, but only their own life or life circumstances. The relation to public goods is statistically constructed by the researcher using, for example, multiple regression analyses. Methods of assessing the value of a *particular* good or service are the content of chap. 5. Here the conclusions are that contingent valuation provides reasonable values, but is unsatisfactory because it is rather insensitive to the quantity and scope of the goods provided. Moreover, there are taboo themes where money cannot be applied as a universal measure. Alternatives are budget games or questions that capture preferences for spending more or less or the same for certain government services.

Kemp's preferred approach to valuing government services is psychophysical scaling. This approach is not well known in economics, and Kemp tries to change this situation with a clear description of the method and numerous applications of his own. Psychophysical scaling has been adopted from psychology and goes back to Fechner's publication of *Elemente der Psychophysik* (1860). Two questions summarize the expected insights from psychophysical scaling: (i) How do people perceive qualities of stimuli such as, e.g., the loudness of a sound or the seriousness of a crime? (ii) Is people's subjective rating related to objective correlates such as, e.g., the actual physical intensity of a sound or the actual prison sentence for committing a particular crime? There are two main methods for valuing stimuli: magnitude estimation and category rating. With magnitude estimations, people are first provided with an anchor, e.g., a particular sound intensity that is assigned a standard loudness with the value 100. In pairwise comparisons, respondents are asked to rate other sounds according to how many times louder or less loud they are compared to the standard. Proponents of this method claim to obtain a ratio scale for subjective loudness. It is then correlated with the underlying objective scale, whereby a linear relationship is proposed between the logarithm of the psychological magnitude and the logarithm of the physical magnitude. With category rating, people give answers on a bounded scale, e.g., between 0 and 10, where 0 is denoted "no value" and 10 is denoted "very high value". Here, it is proposed that the relationship follow Fechner's Law, i.e., a linear relationship between the category rating and the logarithm of the physical dimension. With both methods, there is the claim that people do have particular internal scales, and that they can report on them reliably.

Kemp applies the two methods to valuing goods available on the market, as well as to goods and services that are supplied by the government. For market-supplied goods, a high correlation between the logarithms of the costs and the logarithms of the median reported values is found. It follows that shadow prices of unpriced items, such as, e.g., fine weather next weekend can be calculated (given that value reporting in fact follows the representation underlying psychophysical scaling). A critical interpretation of the results, however, could be that respondents guess the market prices of the goods they have to rate and divide them by the estimated price of the comparison standard before they report subjective values.

Given that the psychological representation of value works, one could try to apply the same approach to valuing unpriced government services or regulations such as, e.g., joining an international criminal court, foregoing the use of atomic energy or adopting a liberal abortion law. As an aside, I do not see how negative values can be captured with either of the two methods such as, e.g., some pacifists might attribute to military spending. However, as the studies by Kemp and co-authors show, there is no systematic correlation between the subjective evaluation of publicly provided goods and services and their costs, even when people were asked about marginal changes in provision. "Overall, the results suggest that people do not distinguish marginal and total utility for government services as they do for personally purchased and consumed items" (p. 106). Some explanations are discussed; however, the author does not ask whether people evaluate private and publicly provided goods differently (I do not think they do) or whether they just lack experience in "buying" the publicly provided goods. Citizens in representative democracies can only vote for a party when they decide about public services and thus have to value policy "packages" at the most aggregate level. According to this interpretation, institutions matter and induce more or less marginal thinking in the evaluation of public goods. A testable hypothesis would be that, with direct democratic decision-making, and therefore an unbundling of issues, there is much more marginal evaluation.

In chaps. 7, 8 and 9, some information issues (e.g., fiscal illusion), as well as citizens' preferred scope of government activity and their preferences for government intervention, are addressed. The author asks what people know about the costs of providing individual government services, and how their knowledge relates to their valuation of government services. Kemp's survey results show that people underestimate the costs of expensive services and overestimate the costs of inexpensive ones. When people were informed about the actual costs of services, their value ratings were not greatly affected. Moreover, "the distinction made in economics between private and public goods seems to have little reflection in the valuations" (p. 168).

Chapter 10 draws conclusions and addresses some of the more fundamental aspects of valuing government activity. Kemp argues that valuation is "of special importance" because "inference from people's behavior is rarely possible or meaningful" (p. 161). This argument is mainly valid if one follows the idea of a social planner who tries to maximize some notion of aggregate subjective well-being of the population. The underlying view is that we could improve the provision of government services if only we had better measures. Research in political economics, however, gives ample evidence that this is a futile approach if one wants to draw policy conclusions. Bureaucrats, regulators and politicians have their own interests and ideologies, which they try to follow within the restrictions formed by the political institutions. Although the book wants to give a psychological approach to government spending, this and other insights from political economics could be fruitfully taken into account throughout the book. For example, why are people so poorly informed about the costs of public services, and does it matter? At least one reason for representative democratic decision-making is the reduction of information costs for the members of a polity. Thus, it is optimal if they know more about goods that they privately buy on the market than about the costs of public services. Of course, voters can make better decisions at the poll when they know more about government activity and spending. However, citizens have low incentives to be well informed about these issues, and it depends very much on the political institutions to what extent political information becomes a private good. It would be interesting to apply the methods proposed in this book to compare results for different levels of a federal system, for democracies with proportional versus majoritarian representation, and for states that allow referendums and popular initiatives. These remarks suggest a procedural view that recognizes that studies about the valuation of government services are used by the different actors in the political process to pursue their own interests. This need not be evaluated negatively because, in a democracy, better information about government activity, its costs and its valuation will intensify political competition, and therewith public goods can be expected to better fulfill private wants. In this respect, insights from psychology are most helpful in complementing basic economic concepts; and Kemp's work is readily accessible to economists. He bridges the gap between psychology and economics with his expertise in both fields, and hopefully his innovative survey research will be taken up.

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