Economics as a Foundation for Public Management. The Bureaucratic Organization

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Abstract: *In this article, we make the case in favor of founding the management science on the relevant conclusions of the economic science. Therefore, the study of incentives and constraints that public servants (and in particular the bureau chiefs) face are essential for understanding their productive behavior. The environment of a governmental bureau in a democracy needs a careful examination. On this basis, some aspects of public production are inspected, as revealed by the Public Choice school of economics: the tendency toward budget maximization, a much lager output at increased costs, etc. The phenomenon of bureaucracy, which is the main cause of dissatisfaction and criticism related to public production of goods and services, is also discussed. After a brief review of the history of the phenomenon (by discussing some theories authored by a number of renowned researchers such as Max Weber, Anthony Downs, Ludwig von Mises, and William Niskanen), the main features of the contemporary bureaucracy are discussed. We also analyze the implementation stage of some general actions for Romanian public administration reform from a European perspective, such as the law regarding the free access to public information.*

Keywords: *public sector, bureaucracy, democracy, secrecy, Public Choice*

Introduction

One of the several sources of the management science is economics. In the last decades, the Public Choice school of thought has influenced in a decisive manner economics, in particular public finance, and the whole group of sciences that study the collective action of people in society. Unfortunately, the science of management remained untouched by the advancement of the Public Choice school. Only recently, the science of public management has incorporated some ideas from the newest directions in economics (Dobel, 2007: 163). New Public Management has been influenced by some Public Choice discoveries, such as the information asymmetry between bureaucrats and politicians, principal – agent problems, and self-interest motivation of private firms managers, as well as public managers.

1. Politicians and bureaucrats: deciding and implementing decisions

Until recently, the most important scientific contributions to the study of the behavior of the public servants have been made by sociologists and political scientists. Their implicit hypothesis was that public servants would carry out the decisions made by politicians impartially and faithfully. Only a few decades ago, public administration began to capture the attention of the researchers in the field of economics.

In a stark contrast with the presence of the public sector of the economy in our daily life, economists either ignored it, or paid little attention to it. Many times, they tackled the problem of bureaucracy superficially and associated it with lengthy procedures, slowness, and rigidity of some organizations. This phenomenon has traditionally been considered as a deterrent to economic efficiency. The best way to avoid it was thought to be the professional training of all involved personnel. The problem with the public sector of the economy and bureaucracy are much more complex, with causes related to finding the proper role of government activity and its relation to the free trade among individuals. The mechanism of collective decision-making is essential in understanding the way in which bureaucratic behavior can determine the outcome of economic policy. Individual preferences related to the quantity of public goods produced are revealed through voting. Politicians make decisions as a result of voting, and their decisions are implemented through the bureaus of the public administration system. Consequently, the decision making process comprises two phases:

1. Policy design, and
2. Policy implementation.

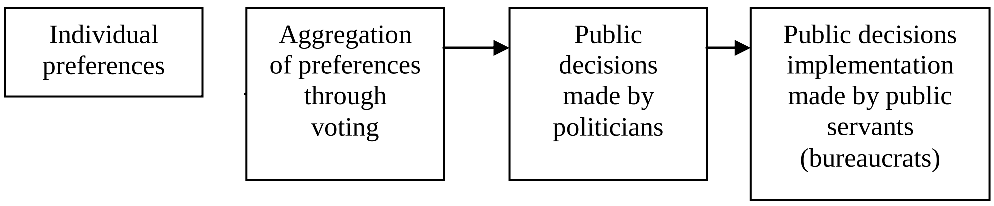

Figure 1. The chain of public decision making in a democracy
(**Source**: Iancu, 1998: 451)

At the theoretical level, researchers in the field of economic policy have been interested mainly in economic policy design. Economists hired by the government draw specific actions to be taken and they recommend them to the decision makers (politicians). However, the outcome of the economic policy can be influenced by a group of professionals rarely taken into account: the public servants that implement the decisions made by politicians. The second phase of the decision making process is usually carried out by professionals working in different state agencies. A new branch of management – the public management – has been designed in order to study and make proposals to improve the outcome of a government bureau. Until recently, a theory of policy implementation was missing. Its inception is related to the increased interests in the results of ever-growing state involvement into the economy.

The emergence of a theory of policy implementation leads to terminology clarification. The scientific terms used had different meanings over the time. The term *bureaucracy* means the organizational method specific to a bureau. The *bureau* is the nonprofit organizations that are financed by a periodic appropriation or grant – usually from the government. The *bureaucrat* (or a public servant if the bureau is a governmental agency) is a person that works in a bureau.

Public Choice theorists see politicians as hired agents directly by the members of a collective for supplying public goods. Bureaucrats are also agents, but the politicians hire them. Short-term bureaucrats are hired by a politician for a period no longer than the politician's tenure. Long-term bureaucrats are hired permanently. They have all the long-term employment rights. They cannot be replaced unless they have been guilty of improper conduct or unless the job for which they were hired was abolished. Rational long-term bureaucrats are biased. The public administration system is characterized by two kinds of biases: conservatism and large governments (Gunning, 2003, p. 81). The bureaucrats have an incentive to keep the system more or less unchanged, except of course for trying to increase their pay and other benefits. On the other hand, bureaucrats have the power to influence the legislative process to their benefit. This brings in a bias toward a larger government. A strong source of bureaucrats' power is their feature as voters. They are usually well informed about the government intentions and form a serious pressure group.

The relationship between politicians and bureaucrats is of particular importance to the study of economic policy. As the Public Choice theorists point out, the main goal of any politician is to be reelected. Bureaucrats can either help or harm a candidate for election. They can cooperate or resist candidates who want to prepare for a public debate regarding their agency. In exchange for bureaucrats' cooperation, politicians offer resources that they have access to. This means higher budgets for a bureau that took the opportunity to help a particular candidate. There are strong reasons to believe that the budget of bureaus is larger than it would be efficient from voters' perspective. Moreover, the size of governments tends to be bigger than it would be efficient.

2. The economic analysis of public production

In social sciences, the study of public production of goods and services starts with the German sociologist Max Weber. Writing in the 1920s, Weber thought that a modern government should be impartial. To him, the bureaucracy appears as the essential form of public administration. The features of the bureaucracy that Weber identifies are as follows: 1). a hierarchy of authority; 2). fixed and official jurisdictional areas; 3). written rules that must be followed; 4). duties that require loyalty and bureaucrats' vocation (Iancu, 1998: 453). Hence, the Weberian image of bureaucracy is characterized by strong hierarchy relations. He proposed two mechanisms that can be used to assure that bureaucracy does not forget its mission. In the case of non-specialists, he put his faith in a hierarchical bureaucracy in which the bureaucrats were insulated from political forces by a civil service system. In the case of specialists, he recommended the adoption of a moral code (Gunning, 2003, p. 276).

Weber suggested the adoption of a set of rules based on his idealist image of bureaucracy. In a real democracy these proposals cannot work. If we broaden our perspective, it is evident that these propositions do not take into account the bureaucrats self-interest. Rational bureaucrats have a strong incentive to favor a continuous increase of the bureau's budget. Higher budgets typically mean a greater ability to achieve your goals, no matter what your goals are. Bureaucrats realize that they can best accomplish their goals with large budgets and they tend to advocate these and to support a bureau chief who does the same. Moreover, self-interested bureaucrats are unlikely to be efficient if, to do so, they must accept a lower budget or face a lower degree of job security. A bureau chief who tried to implement a policy that reduced lower level bureaucrats' security and the budget could not expect to achieve much cooperation from the lower level bureaucrats.

Ludwig von Mises (1944) is considered the first scholar who studied the productive behavior of bureaus from an economic point of view. Mises presents his theory of bureaucracy in his famous book published in 1944, *Bureaucracy*. Mises regards bureaucracy as a system of management, specifically the one used in public administration. Consequently, bureaucracy does not have a pejorative connotation. It is just a means used to reach an end. Mises considers the wave of dissatisfaction with the state agencies performance as a consequence of a disease that was spreading rapidly: the rise of the state involvement into the economy. The disease is not bureaucracy, but socialism, said Mises. The private enterprise and the governmental bureau are two different worlds. Different incentives and constraints lead the manager of a privately owned firm and the bureau chief to different behaviors. Bureaucracy is an instrument used by the state. The performance of a bureau cannot be compared with the performance of a for-profit enterprise. Therefore, criticizing the activity of a bureau does not help. The only way out is to restrict the size and scope of government. In Mises's view, economic education will lead to a diminished support for large government and to a reduced bureaucracy. In other words, the ideological war is permanent and its results influence economic policy (Carnis, 2005).

Anthony Downs carries on the research on the problem of bureaucracy begun by Weber. In his work *Inside Bureaucracy*, published for the first time in 1968, Downs investigates the complex management techniques of governmental bureaus and develops a theory of management processes of bureaus (Downs, 1993). Downs accepts Mises's idea that bureaucracy is the essential form of public administration. Downs defines the bureau as the organization that has the following four characteristics:

1. It is large; that is, the higher-ranking members know less than half of all the members personally.
2. A majority of its members are full-time workers who depend upon their employment in the organization for most of their incomes.
3. The initial hiring of personnel, their promotion within the organization, and their retention therein are at least theoretically based upon some type of assessment of the way in which they performed or can be expected to perform their organizational roles.
4. The major portion of its output is not directly or indirectly evaluated in any markets external to the organization by means of voluntary quid pro quo transactions (Downs, 1993: 80).

Unfortunately, many phenomena are left unstudied by Downs: the author does not take into account the consequences of the bureaucrats' behavior over the budget and output of the organization. A great deal of questions is left unanswered: which is the output of a bureau under certain demand and cost conditions? How does the output change with changing demand or cost?

Public Choice theorists have had a great influence in the study of the state and the public production of goods and services. James McGill Buchanan and Gordon Tullock inaugurated the field of Public Choice in 1962 with their book "The Calculus of Consent: Logical Foundations of Constitutional Democracy". Their work has been translated into Romanian by Professor Paul Fudulu in 1995. A Public Choice theoretician, William Niskanen (1971) makes the first attempt to analyze the bureaucratic phenomenon from a strictly economic point of view. His studies had a prominent impact on later developments on bureaucracy. Niskanen focuses primarily on the environment of a governmental bureau and on the production behavior. His theory provides answers to the following questions:

- What is the equilibrium level of output that a given bureau is interested to achieve?
- What is the relation between this level and the optimal level form politicians' point of view; and between this level and the level of output reached by a competitive industry?
- What are the characteristics of bureaus' environment that influence their behavior?
- What are the effects of different tax systems and voting rules on the level of public services approved by a representative government?

Normative questions are of type:

- Should a given public service be supplied by one bureau, two or more bureaus, or by other form of organization?

- What changes in the bureaucracy and the political institutions should be made to increase the net benefits from the supply of pubic services? (Niskanen, 1994: 11)

Of great importance is, in Niskanen's approach, the environment of the bureaus. This environment is characterized by the set of incentives and constraints of the bureaucrats. The analysis is the starting point of Niskanen's theory. By comparing the productive behavior of bureaus to private firms, one can draw useful conclusions about economic efficiency of the two methods of production. The conclusions of Niskanen's model are:

1. A bureau will supply an output to twice that of a competitive industry;
2. At the equilibrium level of output, a bureau generates smaller net benefits than a competitive industry;
3. The situation preferred by the politicians is that where the level of output of public service is between marginal cost and marginal evaluation of the median voter (Niskanen, 1994: 64 – 65).

3. The bureaucratic behavior

The neoclassic theory of the firm is used as an analogy in the analysis of the productive behavior of the public servants. Any theory of human cooperation needs some hypotheses about the peoples' objectives. It is assumed that the objective of a privately owned firm is to maximize its profits. The objective of the public servants was assumed for a long time to be the general welfare, or the same as the objective of the government.

The assumption that Niskanen uses is that public servants act for the maximization of the budget of their organization. The budget-maximizing bureaucrat has become a central figure in the economic theory of bureaucracy. William Niskanen proposed this model of bureaucratic behavior in 1968. Since then, Niskanen's model has turned out to be the starting point in every discussion about bureaucracy and the best way to deal with it.

An important extension of the model proposed by Niskanen in 1968 was made by Jean-Luc Migué and Gérard Bélanger. They analyze the discretionary power of the bureau chiefs. The discretionary budget becomes a corner stone in the theory of bureaucratic management. In a reassessment written at more than twenty years since his initiation, Niskanen acknowledges the scientific virtues of the contributions made by Jean-Luc Migué and Gérard Bélanger. Niskanen suggests that the budget maximization assumption should be dropped in favor of the assumption of discretionary budget maximization (Niskanen, 1994: 281).

The main objective of the authors is to measure the resources that a bureau chief can use for different purposes in order to gain satisfaction. The ways in which a bureau chief can gain utility are numerous: salary, reputation, perquisites of office, and the level of efforts. The general rule used by the authors is the following: the margin of discretion enjoyed by the manager is represented by the excess of revenue over minimum cost, i.e. by the difference between the maximum profit attainable and the minimum profit tolerable.

The system used for hiring and promoting bureaucrats deserves a closer examination. Lower level bureaucrats are hired through the civil service system. Consequently, it is very difficult for a bureau chief to hire specialists. Civil service examinations cannot adequately test for specialized skills. Often, a specialized skill must be learned on the job and it is sometimes not truly tested until an unusual event occurs. The fact is that a civil service system is not suited for selecting individuals who would find in their interest to serve citizens. Yet, the civil service system appears to be necessary to assure that the bureau chief does not misuse his entrusted powers.

4. Secrecy: Causes and implications

The public servants' bias toward secrecy is well known. In the theory of production through bureaucratic organizations, one important attribute of the bureaucrats-politicians relation has been identified: information asymmetry. This situation occurs whenever one part in a transaction knows more about than the other part the relevant characteristics of the product. There are two kinds of relevant information in any transaction: information about demand and information about supply. Each part involved in a transaction has an interest in knowing the intentions of the other part. Public servants, and especially the bureau chief, are in a better position than the supervising politician regarding the access to information. Usually, the bureau chief has information about the demands for his services but the politician that information about the bureau's costs. The bureau chief can easily have access to relevant information about the demand for bureau services, as government and the legislative meetings are usually open to the public. The politicians cannot keep secret the demand for bureaucratic services. However, the situation is asymmetrical: politicians cannot easily have access to a bureau's costs. Nobody knows better than the bureau chief the degree to which some costs lead to improved outcomes. Thus, the bureau chief has a strong incentive to be secretive with regard to his activity. The consequence of the information asymmetry is that the bureau chief can increase the budget of the bureau to a level that is greater than the political optimum.

5. Guidelines for reformers

National governments probably should not supply many services. Allowing private firms to bid for the contracts could be more efficient than maintaining a government bureau. The best policy in this case is the privatization of the bureau. I will consider below some procedures for improving the activity of a bureau assuming that the bureau is worth keeping.

Propositions for creating a new bureau are made by legislator whenever there are prospects that a problem could be solved through political means. To ensure that the proposed bureau is efficient, the proposition should be accompanied by a cost-benefit analysis and the analysis should be made available to the public. The cost-benefit analysis should use uniform accounting standards.

Any bureau's activity is difficult to asses due to the very nature of the public goods that they are assigned to produce. Nevertheless, the government should create an independent accounting bureau. In order to check on the benefits and costs, the accounting bureau should have the right to inspect all bureau documents without notice. In Romania, the Court of Accounts is the supreme body of external subsequent financial control on the formation, administration, and use of the financial resources of the state and the public sector.

One of the most important rules related to the activity of bureaus is open access to public information. Citizens and media reporters should be free to inspect bureau activities and communications at a minimum cost. With the exception of some part of the national defense and police bureaus, all government activities and bureaus should be required to adhere to this rule. Although a country may have a law regarding free access to public information, in practice the law could not be properly enforced. The Romanian legislative adopted the law regarding free access to public information in 2001. The Romanian experience shows that the enforcement of the law left much to be desired. As numerous civil society observers reported, many public institutions were exempted from the provisions of the law.

Conclusions

Analyzing the set of incentives and constraints of the public managers, one can propose a group of public administration reform measures. Yet their success is uncertain. However, one thing is clear: the science of public management can contribute to the design and implementation of reform measures only to the extent that it basis its propositions on the relevant conclusions of economics. Some features of the governmental bureaus activity are drawn by incorporating in public management the newest findings of economics, in particular the ones of the Public Choice school.

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