

THREE THEMES IN INSTITUTIONS AND PUBLIC ECONOMICS*

Bruno Miconi
Dipartimento di Economia Politica
Siena University

February 1995
No. 2

EU CompEcs

*A Network of the Human Capital and Mobility Programme
Working Papers Series*

THREE THEMES IN INSTITUTIONS AND PUBLIC ECONOMICS*

Bruno Miconi
Dipartimento di Economia Politica
Siena University

February 1995
No. 2

Abstract

The following three themes are all part of the new political economy. In it the libertarian stream of thought is very relevant, so that the first part of the article deals with the libertarian utopia. The conclusion is that critical remarks can be addressed to such an utopia. An approach to public goods, fairly different from the usual one, is suggested in the second part. National States figure prominently in it and a methodological holistic approach is required.

The third part deals with problems of bureaucratic reforms and relationships between politicians, bureaucrats and citizens.

* Paper presented at the EUCompEcs annual workshop held at IDSE, Milan, on 16-17 December 1994. It reports research work carried out within the EUCompEcs project. The present work, as well as the unpublished papers of mine referred to, should be considered as work in progress. Thanks are due to F. Farina and M. Franzini for comments. The usual proviso applies.

EUCompEcs is the acronym for a research network established under the programme Human Capital and Mobility, with a contract no. ERBCHRXCT930231 (1993-1995) and extended to Central Eastern European Countries, with contract no. ERBCIPDCT940015 (1994-1996).

Participants are: Dipartimento di Economia Politica, Siena University; CNRS-LATAPSES, Sophia-Antipolis; Fakultät für Wirtschaftswissenschaft, Otto von Guericke Universität, Magdeburg; PREST, Manchester; IDSE, Milan; Departamento de Analisis Economico, Valencia University; SSSUP "S. Anna", Pisa; Institute of Economic Studies, Charles University, Prague; Systems Research Institute of the Polish Academy of Sciences, Warsaw; Department of Business Economics, Budapest University of Economic Studies.

The general guideline in this network research is the development of a computable economics approach to analyse institutional and structural change viewed as an integrated dynamic process. The central objective of the activity of the network is monitoring, from the individual countries perspectives, the long term dynamics of the European scenario, resulting from the fundamental choices that are being made.

E-mail Address: EUCOMPECS@UNISI.IT

1. Introduction

Economics considers not only the market but also different organisations, for example firms and public organizations, among the institutions of an economy. The behaviour of public organizations, manned by a bureaucracy, pertains mainly to the field of public economics. This last one then, from the point of view of the study of the economic actions, overlaps inevitably with the theory of the firm. Following a fairly developed custom, I will indicate together public economics and institutional economics with the term new political economy¹.

Our first theme will be dealing with those authors, which are often called libertarians² and who are conspicuously present in the field of the new political economy. Public goods will be approached from a point of view, different from the one usually followed in the literature, which will focus on the existence of different national States. This will constitute our second theme. The third theme will consider laws, rules, orders internal to a bureaucracy as instruments of power in a coalition game between bureaucrats, citizens and politicians, considered also in their capacity of exchanging the roles of principals and agents among themselves.

2. Is the Libertarian Utopia the Perfect One?

In the economic life of a collectivity, not all economic activities take place through private exchanges on the market. There are also other ways of organizing these activities, some of a private character, exemplified by private firms, and some of a public character, exemplified by the State. The libertarians are, generally, in favour of the least possible intervention from the State, so that the maximum amount of the economic activities should happen outside the public sphere. According to the libertarians, as well as to many institutionalists -and, very often, economists at large- the term of comparison to which organizations and decisions are to be referred to are the markets and, in the second place, the private organizations that act on the market. In the absence of transaction costs, the market is said to be the best possible and most efficient way of conducting every possible activity. Given transaction costs, private organizations under competitive conditions follow suit. The State in its turn can be introduced in the analysis by some sort of a prisoners' dilemma and the necessity of coordination of the actions that the private persons involved in the game could be following. In the efficiency table, mainly for monopolistic public organizations come last.

¹See, for ex., Inman.

²A list of them would be too long. It is enough to notice that their share in the economic profession seems to be increasing; that they have a tradition going back, in modern times, to Hayek; that they relate to the Chicago, Virginia and Austrian schools. They also include many philosophers like Nozick 1974.

In this analysis, in a way that will be discussed also in par. 2, at the beginning there is the market. The other institutions are introduced in terms of increasing distance from it, needing theoretical reasons for their existence. We can attribute the main reasons for the existence of firms, i. e. transaction costs, to imperfect information and the existence of the State to the possibility of free riding. In the presence of free riding the market will fail as to justify different public organizations. However, the libertarians notice, the State can fail even more: the market should be doing all that it can do and something more as well.

There it is immediately one odd thing to notice about the libertarians. Although, as a group of people, they do research in different fields of economics, no one of them uses to work directly in the field of general economic equilibrium (gee)³. Now this approach represents the only way to interpret the market to be such as to obtain the result of Pareto efficiency. If the libertarians do not follow it, one wonders, first of all, where they get the result of optimality they attribute to the market. If such a belief comes out of their experience of the world, such a belief, like any other, requires to be supported in terms of a theory. If the theory they follow is of a partial character, no general proposition can come out of this for the economy as a whole. Gee is the theory to which one has to refer in order to prove the efficiency of the market. The only way to judge the libertarian utopia is to build a world where one can apply that general economic equilibrium analysis and give judgements on the situation that one would obtain in that world.

As it has been said, in a world of general economic equilibrium, organizations would be redundant, because all contracts could be written in complete terms and information would be perfect. When information is so, furthermore, public goods can be dealt with in terms of Lindahl equilibria, so that an economy of this kind would deal efficiently with all the economic problems that people would face.

Suppose now that all goods, different from rules, laws, etc. could be privately owned, because property rights can be such that those common and public goods which do not consist only in abstract words -like for ex. laws (the republic is founded on labour) or feelings of belonging (all people belong to humanity)- can be attributed to private agents, so that the consumption of them by other agents can only take place following a commercial deal in terms of prices. (Think for example of electronic devices which could divide the space in such a way that the passage, or even the simple look inside the privatized space could be registered in electronic cards which might at regular periods give rise to payments, to defence weapons which could defend every individual citizen and his or her private space, and so on). Suppose, furthermore, that the remaining abstract public goods, rules and laws, can be dealt with by various different communities which could form voluntarily so as to choose unanimously the system of taxes, laws and abstract declarations which would be valid in that community and that production takes place at non increasing returns to scale. We would then obtain the libertarian utopian world, one that would leave all decisions to the voluntary contracts of

³Libertarians sometimes declare this openly. In their view general economic equilibrium analysis is too abstract and not such as to represent the main properties of an economic system.

individuals; we would then be able, in a Pareto efficient way, to be in the best of all possible worlds.

It is easy to see that in such communities the coercive State, probably the main enemy of the libertarians and, according to them, a very important danger to avoid, is absent. The State here is simply the set of rules that people choose voluntary to follow. All other contracts on the market would also be equally voluntary. The taxes to pay and the laws to obey are voluntarily chosen, in an extremization of Tiebout model, as to form voluntary clubs, and the rest of choices are transmitted through the market. At last there would be no paternalistic and coercive State, but simply voluntary aggregation of people who voluntarily and unanimously chose to live in certain communities.

Would this utopia be desirable? My reply is no and it derives from two sources: one is the possible non efficient character of such a world, the other the existence of (private) coercion in the same situation.

Briefly, the first character would derive by the fact that the general equilibria of each single communities would not, in general, be unique, and that the process of equilibrium selection among them is not such as to certainly choose an efficient position⁴; the second one would derive by the possible asymmetric positions that people would find themselves into, in relations to reciprocally advantageous contracts meant to avoid very serious bad consequences, which for some (but not all) people would have a character of private (Marxian) coercion⁵.

These theoretical results would then illustrate the fact that the libertarian utopia can come out to be inefficient and, if one accepts the situation of private coercion as morally reprehensible, unjust, even granting a world in which what the libertarians look for can materialize for certain. The possible existence of private (Marxian) coercion and of market inefficiencies are still there to cast doubts on the justice and efficiency of such an utopian world even if one grants that all the conditions for its existence materialize.

3. Public Goods

In economic theory public goods are identified in terms of two characteristics: I) all the consumers consume the same amount of public goods (in such a way that, unless congestion is there, the addition of more consumers for them neither diminishes the amount of all other goods nor the amount of the good in question) (non rivalry); II) it is very difficult to exclude somebody from the use of a public good (if that person has not paid its part) (non excludability).

Let us first exclude from public goods those which consist of definitory abstract terms. (We have already hinted at them above and will deal with them again below). I will argue that the two characteristics above for public goods derive in the first place from the technology of (non) protection of property rights

⁴ See Miconi Pacini.

⁵ See Miconi.

and in the second place from the existence of national States. In both case a central aspect of a public good is its common, public ownership.

As for the first aspect. The technology of protection of goods and services is today -in the world as we know it, rather than in the theoretical imagined case of the previous par.- such as not to be able to allow private property on some of the goods or services of an economy, because these goods and services cannot be protected in such a way as to allow the individual owner to exclude other people from the use of those things. (Think, for ex., of the (air as constituting a) common space). Now, if these goods and services are, somehow and somewhere, scarce in an economic sense -i.e. their marginal utility is positive for at least one member of the collectivity who has positive income- for efficiency reasons these things must be owned. Not being possible their private possession, they must then be owned publicly. Public or common ownership then is today unavoidable, given the impossibility of private ownership of certain goods.

In principle the consumption of a publicly owned good or service could be the same for everybody belonging to that community. If, now, the financing of that good or service is independent of the direct consumption of it, so that controls are difficult or impossible or simply not implemented, that service or good fulfils the traditional definition of a public good. On the contrary, if something is privately owned it must instead be possible to exclude people from its consumption, which means that its consumption could be in principle not equal for owners and non owners.

Being, on the other hand, the technology of property rights related to objects and services, we can state again that our argument does not relate to those words, terms of technical language, ideas, feelings, principles, which, considered as goods or services, are treated in a pervasive and, in my view, unjustified way by the economic analysis as characterized by complete joint consumption and non excludability. The examples of such terms, considered as public goods, are many (information, law, nationality, etc.). These terms however constitute simply definitory properties or indicate some abstract activity (for ex., an activity called law to which certain people are submitted). As such they do not, outside their mundane existence (information about a fact by an agency, courts and judges, American or Italian), constitute goods or services capable of being dealt with by economic theory. Hence they should be ignored, outside their mundane existence, by an analysis on the classification of goods and services into private and public.

It is in fact immediate that any definition that is relevant to more than one person satisfies non rivalry. As for non excludability this will again be satisfied by all the people involved in the definitory or abstract activities, being these last ones, outside their mundane existence, independent of the payment related to them.

Many things are owned commonly. Often the common ownership is simply organized by people who decide voluntarily and freely on this kind of ownership. In these cases there is always the possibility to withdraw from that ownership by quitting the community of the owners and renouncing what is owned commonly. When this is possible we are dealing with club goods. Some other times such an

ownership is not decided freely. The obvious example of such an instance is given by the State. This is a community in which the above actions are (almost) impossible, and, in any case, require the consent of the community itself, which has then some power of coercion on the actions of the individual, even if that individual does not want to belong to that collectivity⁶. In our approach we distinguish public goods from club goods. For the first ones the ownership of public good is (almost) not renouncable without the consent of the collectivity itself. Public goods are then, in our view, the goods that are commonly owned in the only organization (the State) having the above seen characteristics.

Once we have reached the above conclusion, on the existence of the State as the owner of the public goods, the next immediate step is to recognize that of this kind of owner, the State, there is more than one: the national States. The existence of several national States, as a datum in the theory, implies now the possibility to enlarge the actions to be considered in any real economy. Direct actions that national States do in order to protect their existence go in fact further than the simple preferences of the citizens and the technology of protection of goods would justify. In a competitive world of different national States many of the actions taken by these new actors should be interpreted not as the being defined in the field of consumption by the citizens, but rather as interdependent strategic variables, in order to assert the existence, the power and the reputation of different national States in the reciprocal competitive strategic behaviour related to variables wider than those pertaining only to the economic field.

(Limiting our approach to the economic field, it is as if in the modern theory of the firm, people who are part of it, would be considered only as consumers of the things that firm produces, and not also, in their role as personnel of the firm in which they work).

In order to do that, right from the beginning national States intervene in the life of people. People, then, being customers of public goods owned and provided by the State are also subjects to their State. The actions of these national States on those matters could then well be considered paternalistic⁷, but, given the concrete situation -very different from the one imagined in the literature- they are also quite inescapable.

The existence -exogenously to the economic field- of that (kind of) State and of the national States, their multifaceted aims in a rather complicate strategic environment, go a long way to explain why, although some of the goods and services owned by the State do possess a technology of protection quite capable of allowing them to be owned privately, not only these goods are owned publicly but also their financing, in presence of its possible direct implementation, is organized in such a way as to fulfil non excludability. (Think for example of education, research, culture). These goods and services then constitute, so to speak, public goods and services by choice, rather than by necessity, contrariwise to goods and services owned publicly by the State and which must be financed by indirect

⁶ Compare Stiglitz.

⁷It could be taken to be a stimulus to preference development as in the classification of Burrows (pg 558).

means . (Examples of this kind can be the activities related to defence, or the implementation of the criminal law).

Politicians, as managers of the national States, have several roles. They should satisfy the citizens as clients of the State in their use of the commonly owned goods and services, run the State in the competitive outside world, related also to fields other than economics, exercise some redistributive actions. The problems are even more complicated because all these three activities are strictly intertwined in the competition among national States. The plurality of national States and the above activities then explain many characteristics of their mundane existence -for ex. in relation to education⁸ or culture or research and so on- which are much more difficult to be explained, in terms of their size, if not of their existence, following the traditional definition of public goods.

Public goods, in the approach, are then characterized by I) equal consumption (at least in principle), that is no rivalry, II) public common ownership by the national States, III) indirect financing of them, that is non excludability.

Point II of the definition is new and distinguishes in our approach public goods from club goods and explains why point III of the definition is fulfilled sometimes by choice, and sometimes by necessity.

The above situation gives rise, of course, to many problems which, as it should be clear from the above exposition, would relate together economics and politics. These problems would especially be numerous with reference to those activities which we have called public goods by choice.

If in the literature these activities are simply considered in their aspect of the consumption of the goods and services by the citizens, and not also in their interconnected aspects of competitive and redistributive variables, then the reasons offered for public intervention have to be found in a market failure or in the traditional publicness of the good or something else.

If considered however in the aspects here individuated, that is as part of the competitive strategies and decisions related to an internal and external environment -as for example it is done, in the restricted field of economics, in the modern theory of the organization and management of the firm in relation to its internal problems, as well as with an eye to the external world- the problems related to those activities could be dealt with more perceptively.

To close the second theme I will also try to make some methodological points. One pretty obvious is that some kind of holism might be necessary in the methodology of economics whenever we find organizations, like the existence of several national States, which cannot be attributed to the will of the single individual actors on the market. They are then not variables to be explained by the rather simple procedures of egoism and utility maximization, but should be taken

⁸Politicians in general are in favour of public education, in Plott's opinion, because people educated by the State, would be ready to allow more transfers, than people educated privately (see Plott). The interpretation of the actions of the politicians in terms only of redistributive activities seems however particularly limited, given the situation seen in the text.

as given, at least at this stage, in the analysis. Their existence should be considered in order to explain some, otherwise badly understood, aspect of the real economies.

The second methodological point, strictly related to what we have just seen, is that to start from the market as the paradigm from which the other organizations should be derived by differences is not the approach we have used here. In our approach, contrariwise to the modern approach followed by the new political economists, we do not start from the abstract perfection of the market and build the other organizations, in our case the national States, from the necessity of them to do something different from what this perfect market can do, given the imperfection of the world, but start from the existence of those organizations in order to proceed with our analysis, in an imperfect world. On one side there does not seem to be a convincing way to go from the market to everywhere else, as it is in fashion now⁹, on the other side, the feeling of religious and political belief that the "market first" procedure implies, should, by itself, make one unhappy.

4. Bureaucrats, Electors, Politicians

There are important well known differences between private commercial organizations. on one side and public administrative ones on the other. The range of topics and problems related to external control, the degree and measures of competitiveness, both internally and externally to the functioning of the relative organizations, the different timing of external control and the different logic of collective versus individual decisions constitute well known differences among these two kinds of organizations.

Such differences have been clearly stated in the analysis of the economic behaviour of a bureaucracy. In this way it has been convincingly shown how - given the uncompetitive environment, and the absence of relevant monetary incentives- the bureaucracy, rather than act in the way in which politicians and electors would like, will look for the greatest possible budget and apply a good deal of X-inefficiency in its behaviour.

I intend here to illustrate briefly two topics which refers to a bureaucracy in its relation to politicians and electors :

I) the complicate interactions of bureaucrats, politicians and electors, such that the figures of the principal and the agent get often interchanged among the different actors,

II) the possible meaning and importance of the enormous amount of laws, rules and internal orders used by a bureaucracy involved in a coalitional game with politicians and citizens.

⁹ It is a bit like assuming the use in production of perfect robots in a perfect world, show that the world is not perfect, and discover that human beings are better than robots in an imperfect world, where something unexpected can happen. This explains the existence of human beings in the production process.

Starting from the comparison of the organization of a State to one of a private institution, say a firm, one can derive an analogy about the different roles that the various actors take in the relative institutions. Shareholders, managers, employees represent ownership, control and the controlled working force related to the firm, whereas institutions like stock exchange, investment banks, banks represent institutions of control external to the firm. Those figures in public organizations would take the corresponding figures of citizens, politicians, bureaucrats, and the external to them institutions of control, like elections.

Principal-agent analysis is very often called upon in economic theory for its capacity of clarifying and solving problems of interactions among people, as in the situations just seen. Now when such a construction refers to the organization of the State it is usual to consider the citizens as the principal and the politicians and the bureaucracy the agents, following the same pattern private command organization in terms of shareholders, managers, employees. Or, at a second level, the politicians as the principals of the bureaucracy, which is the agent.

In the State, however, the relative roles of the three categories above seen depend on the kind of alliances that could be formed among them, in such a way as to neutralize any easy classification of them in the usual principal agent relation.

One can immediately think of three different cases, in which the figures of principal and agent could be taken in turn.

Let us first consider the case in which politicians are elected in order to help citizens to disentangle the very same web that politicians have created, in alliance with the bureaucracy, in terms of laws, rules, internal orders in order to create a world apart from the citizens. If these last people's expectations are such that the coming into power of politicians who promise to clear up that web is thought to be unrealistic or to need too much time, then the bureaucracy and the politicians elected according to the aim of just helping the citizens to go through that web, far from being theoretically the agents of the electors, become the principal of the power game which the citizens are conducted to play.

On the other hand the alliances might change: elected politicians and citizens might be there to change policies and restrain, somehow, bureaucratic power. Also in this case the enormous amount of laws, rules and internal orders of the bureaucracy represent a powerful weapon in the hands of this last category in order to fight those attempts. Bureaucrats, in fact, will hide behind that web, in order to countervail the attempts of citizens and politicians to overcome bureaucratic power. The figures of the principal agent analysis are in this case the traditional ones.

Let us now consider the last of the possible situations. Imagine the situation in which the majority of the elected politicians are there to implement some change of policy, but that there are also some part of the electors -not necessarily the minority of them, according to the electoral system chosen- who would ally themselves with the bureaucracy, in order to prevent those measures that the politicians would like to implement, but that that part of the electorate do not want to be followed. The principal agent figures now get multiplied. Some direct agents of some of the principals are the bureaucrats and some direct agents of some of

the other principals are the politicians in power, and (some of) the agents have opposite interests!

It should be clear from the above that no clear cut agent principal problem is capable of giving the solution of such a maze.

Whatever the situation there is one thing to be noticed: in all those possible coalition games the vast jungle of rules laws and bureaucratic orders always works in favour of the bureaucracy! This peculiar aspect of the economics of the bureaucracy is not often recognized, so that pointing it out might be of some relevance: whatever the alliances to be formed, the more rules, laws and internal orders there are, the stronger would be the position of the bureaucracy in the coalition game between politicians, electors and bureaucrats. The cancelling of most of those laws and rules, then, would always weaken the bureaucrats, even if the same action would not clearly reveal in favour of which other category that cancelling would be.

Suppose now that, for whatever reason, one would like, in a power game of the kind above seen, to lessen the power that a bureaucracy can hold. Would not a diminished number of laws etc., by which the power of a bureaucracy, would be weakened, present also shortcomings? For example, could not a diminished number of laws, etc., be reflected in an augmented amount of corruption in the bureaucracy? There does not seem to be a unique reply to this question.

The cutting off of laws, rules and internal orders, could or could not produce a bureaucracy more open to corruption. If, on one hand, controls on the behaviour of bureaucracies are lower and such a situation can create more opportunities of an increased corruption, on the other hand if the number of laws, regulations, and internal orders is reduced, the occasions of corruption might be less frequent than in the opposite case, so that the balance among the two forces has no definite sign.

A different way of reducing the power of a bureaucracy is the practice of contracting out.

Two last observations on this point.

I) Contracting out decreases the numbers of decisions taken by the bureaucracy, and hence weakens its role, but also increases the laws rules etc. by which the outside contractors have to be controlled, and by this road, strengthens at the same time the role of the bureaucracy so that again the balance among the two forces has no definite sign.

II) If a bureaucracy is drastically reduced by contracting out, its capacity of control is also diminished. A part from the cases in which the controlled and the controller are the same organization¹⁰, if a bureaucracy is drastically reduced by contracting out, it will be left with all those activities which cannot be dealt with in such a way. Now these activities are exactly those in which procedures are more important and easier to ascertain than results. The activity of the bureaucracy would then appear, by its very nature, inefficient and time consuming and the bureaucracy itself will be seen in this light. It will be then very probable, that this

¹⁰ See Di Iulio et al..

bureaucracy will hide even more, for defence purposes -given the existing amount of rules and the possibility of creating new ones from the bureaucracy itself, especially in those fields which would in any case left out to it- behind the screen of rules, so that one could get the opposite result from the one is looking for.

A qualified and numerous bureaucracy acting with few rules also in fields in which results are more important than procedures seems to be better way of organizing the public intervention in the economy than an unqualified and small one acting with more rules only in fields in which procedures are more important than results. The fact that the two qualifications on the bureaucracy, that is a bureaucracy acting in several fields, with few rules, seem to be contradictory tells us what a long way there is to go in any reform of the bureaucratic activities.

References

- P. Burrows, *Patronising Paternalism*, Oxford Economic Papers, 1993.
- J.J. Di Iulio, G. Garvey, D.F. Kettl, *Improving Government Performance*, The Brookings Institution, Washington, 1993.
- R.P. Inman, "Markets, Governments, and the "New" Political Economy", in *Handbook of Public Economics*, ed. by A. J. Auerbach and M. Feldstein, Elsevier, North Holland, 1987.
- B. Miconi, *Coerced Choices, Social Relations and Economic Theory*, paper presented at the Moscow Xth IEA Congress, 1992.
- B. Miconi, P. M. Pacini, *Price Systems, Bargaining Theory and Social Relations*, Quaderni del Dipartimento di Economia Politica, Università di Siena, 1990.
- R. Nozick, *Anarchy, State and Utopia*, Blackwell, Oxford, 1974
- J. R. Plott, Jr, "Why is Education Publically Provided? A Critical Survey", in *The Economic Value of Education*, ed. by M. Blaug, Elgar Reference, 1992
- J. E. Stiglitz, *The Economic Role of the State*, Blackwell, Cambridge, 1989

*Stampato presso il Centro Stampa
della Facoltà di Scienze Economiche e Bancarie*

