

I. Introduction: on Bureaucracy.

- A.** We often treat governance in same manner that we look at the production in most economic model of firms: as if governance took place mechanically and automatically. The electorate votes for a referendum, a legislature enacts a policy, a court makes a decision, and whatever is specified actually is adopted as government policy. In the end, **all such policy decisions** are implemented by unelected, and largely invisible, people working within government agencies. What ever "decision" is reached by an electorate, legislature or court, it is "the Bureaucracy" that implements it.
- B.** If bureaucrats entirely disinterested in policy and the "decisions" reached by political decision makers always crystal clear and specific, the bureaucracy could be considered a rather uninteresting area of public choice research. However, if neither of these assumptions hold, bureaus will often exercise considerable *discretion* in the *design* and implementation of policy. Here, analysis of bureaucratic decision making will be required to understand many policy decisions.
- C.** Bureaucrats will have at least some discretion over the implementation of policies for several reasons.
- i. First, monitoring can never be perfect. That is to say, bureaucrats will possess some discretion over the implementation of policy simply because it is impossible to punish them for every possible error in implementation. (For example, some laws may go unenforced, at least on occasion, because no law enforcing agent has an incentive to enforce such laws. No one else knows who the guilty parties are or whether any such parties exist. Consequently there are neither specific rewards for performing one's duties nor penalties for malfeasance in many cases.)
 - ii. Of course a good deal of discretion over policy is explicitly delegated to the bureaucracy. The bureaucracy often has expertise--at the very least knowledge of time, place and circumstance--which policy makers lack. Because of this bureaus are often granted significant discretion to *interpret and implement* "the policy" in the manner that seems appropriate. In many cases, the actual writing of laws (deciding targets for pesticides and food additives) are delegated to the agencies.
 - iii. Politicians may also delegate decisions to the bureaucracy, not because of the bureaucracy's expertise or comparative advantage, but rather to avoid making public commitments on controversial regulations.
- D.** In the end, all agencies have at least some discretion over the implementation of their assigned duties. In cases where the aims of bureaucrats differ from those of the legislature or electorate, an *agency problem* may be said to exist. That is to say, bureaucrats may decide to exercise their discretion in ways that fail to maximize the net advantage of their "sponsors" (the legislators or electorate).
- i. [Figure: Simple Shirking Illustration of a Principal-Agent problem.]

ii. [Shirking with monitoring example: $\text{Max } U^e = P(L)U(Y, L) + (1-P(L))U(Y-C, L)$]

- E.** The modern literature on contracts (which emerged well after the modern literature on bureaucracy) suggests that there are a wide range of contractual means by which agency problems may be addressed. For example, employees (here bureaucrats) may be required to post a performance bond which they may redeem upon successful completion of an assigned task. Wages and salaries might be based on output (bridges built, cases handled, money's dispensed appropriately) rather than the quantity of an input (time spent on the job).
- F.** But, beyond prospects for promotions, such incentives are rarely used within the bureaucracy. Most bureaucrats are paid a straight salary which is largely independent of day to day performance. [In fact, you might argue that, given the method of compensation, agency problems in the US and most OECD countries are surprisingly small.]
- ## II. Niskanen (1971, 1975) proposes a Budget Maximizing model of bureaucratic behavior.
- A.** Why maximize a budget? Niskanen argues that bureaucrats have a direct personal interest in the size of their organization's budget because:
- i. Opportunities for promotion tend to increase, and thereby expected salaries, as budgets increase
 - ii. Working conditions tend to improve--computers, office furniture, secretarial support, etc.-- as budgets increase.
 - iii. Non-pecuniary compensation tends to increase as resources become available for travel or projects of particular interest to a given bureaucrat.
 - iv. Moreover, to the extent that public employees are interested in the mission of their agency or bureau, they will gain additional satisfaction by being better able to advance the agency's mission as their budget increase. (Even very public spirited bureaucrats generally have an interest in larger budgets.)
- B.** Informational Asymmetries. The bureaucratic interest in larger budgets would not be significant, if they had no methods by which they might achieve higher budgets. Niskanen argues that the bureaucrat's superior knowledge of production methods, policy alternatives, (statistical) public demand for specific services, provides them the ability to make all or nothing offers to their sponsors (or oversight committees). In most cases, budgetary requests originate with the bureaucracy.
- C.** Implications. To the extent that bureaus can use all or nothing offers to secure budget increases, they will tend to have budgets that are larger than those which maximize net benefits for their sponsors (ultimately voters or interest groups).

- i. In the case where marginal cost and the demand for the public service under their agency's power are linear, *the maximum budget implies that twice* as much of the service is provided as would maximize net benefits. [FIGURE from lecture]

D. There are many critics of the Niskanen model. For example:

- i. Critiques: Migue and Belanger, 1974: objective function is too narrow, discretionary budgets rather than total budgets are maximized.
- ii. Critiques: Breton and Wintrobe, 1975: competition and monitoring possibilities
- iii. Critiques: Weingast and Moran, 1983: conditional budgets for control (FTC)

III. Extensions of the Niskanen approach

A. Bureaucratic Inertia and Bias (Congleton, *PC*, 1980) [Figure]

B. Full Line Forcing (Mackay and Weaver, *QJE*, 1983)

- i. M and W extend the Niskanen type analysis to a setting where the bureau produces multiple outputs.
- ii. Homogeneous citizens maximize $U_i = u(C_i, X_{1i}, X_{2i})$ where C_i is private consumption by individual i , X_{1i} is consumption of service X_1 by "i", and X_{2i} is consumption of X_2 by i . They are constrained by a budget constraint: $Y_i = C_i + T_i$, where tax payment T_i is a constant share of the total budget spent on government services. Here $T_i = t_i(B_1 + B_2)$.
- iii. Expenditures on government services can be restated in terms of budget share, k , so that $B_1 = kB$ and $B_2 = (1-k)B$ where B is the total budget.
- iv. This allows the voter's choice to be written as: $U_i = u(Y_i - t_i B, kB, (1-k)B)$. (Note that we have implicitly assumed that both government outputs cost one dollar each.)
- v. Differentiating with respect to B and k , we find that the ideal budget level and service mix will satisfy:
 - a. $U_{C(-t)} + kU_{X_1} + (1-k)U_{X_2} = 0$ and $U_{X_2} = U_{X_1}$ simultaneously.
 - b. [Illustration of first order conditions.]
 - c. These first order conditions are the reference point for the M&W analysis.
- vi. In their model, the bureau controls the budget mix and the "voter" controls the budget level.
 - a. If voters can take the budgetary mix as given, only the first f. o. c. is relevant, $U_{C(-t)} + kU_{X_1} + (1-k)U_{X_2} = 0$, and the ideal budget level can be written as: $B_i^* = b(k, Y_i)$
 - b. The Bureau is assumed to set k to maximize its budget. From the implicit function differentiation rule, we know that $B_i^*_{,k} = 0$ when $U_{CC(-t)^2} - 2ktU_{CX_1} - 2t(1-k)U_{CX_2} + U_{X_1} + k^2U_{X_1X_1} - U_{X_2} + (1-k)^2U_{X_2X_2} = 0$
 - c. This is very unlikely to be the same point as required to maximize the "sponsor-voter's" welfare.
 - d. [Illustrating figure with B^* function and k^* functions, based on "Va" above, contrasted with revenue maximizing B and k .]

- e. In cases where voters are not homogeneous, the voting rule becomes relevant. Here they must optimize over the win set of the status quo rather than with respect to a single representative (or median) person's welfare. [Figure]
- f. Note that most models of agency problems can be applied here. For example, the bureau/bureaucrat may have policy preferences, or different degrees of risk aversion. [add bureaucrats indifference curves to figure drawn for d.]

- vii. In any case, M & W clearly demonstrate that the ability of bureaucrats to affect public policy clearly depends upon the range of authority that the institutional and economic environment allows it.

C. Predatory Pricing (Lott, 1990, *J.Pub.E.*)

D. Manipulating the Demand for Bureaucratic services (Congleton and Fabiano, 1997 working paper)

IV. Hiring Bureaucrats: Is the Bureaucracy Biased?

- A. There is a neglected form of principal-agent problem that tends to arise when a government attempts to hire the most-qualified person for every job in the public sector.
 - i. Agents hired under objective productivity standards often have policy interests that differ systematically from those of elected principals and/or the electorate.
 - ii. This tension over policy is an entirely natural consequence of career choices by individuals and hiring decisions within the bureaucracy. Moreover, this tension between agents and principals can be in the interest of a well-functioning government.
- B. However, agent-principal differences over policy can still be a source of significant agency problems in policy areas where agent control problems are severe, as in the case of international treaties. (Congleton, 2002 working paper)

V. Political Oversight: How good can it be?

- i. How much time can a typical voter spend monitoring bureaucratic outputs?
- ii. An interest groups?
- iii. Are there incentive compatible contractual solutions to this agency problem?
- iv. Does the existence of contractual solutions imply that any problems that remain must be Pareto efficient, or even more moderately, efficient from the point of view of the typical voter?

VI. Rational Ignorance, Framing, and the informational importance of the bureaucracy [Discussion]

- i. Consider the role of information in environmental, nuclear, medical, or defense policies?
- ii. How important has information provided by the bureaucracies been to the public policy debates and elections?