

# Public Administration and Public Management

The principal–agent perspective

Jan-Erik Lane

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# Public Administration and Public Management

Government in any society delivers a large number of services and goods to its population. To get the job done, government needs public management in order to steer its resources – employees, money and laws – into policy outputs and outcomes. In a well-ordered society the teams who work for the state deliver under a rule of law framework – public administration.

*Public Administration and Public Management* provides a new perspective on the public sector by offering a concise and comprehensive analysis of what it is and how it operates. This book includes such issues as:

- the principal–agent framework and the public sector
- public principals and their agents
- the economic reasons of government
- public organisation, incentives and rationality in government
- the essence of public administration: legality and the rule of law
- public policy criteria: the Cambridge and Chicago positions
- public teams and private teams
- public firms
- public insurance
- public management policy

This book provides essential reading for those with professional and research interests in public administration and public management.

**Jan-Erik Lane** is professor of political science at the University of Geneva and has taught courses on government in several countries.



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Jan-Erik Lane

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# Preface

The purpose of this book is to suggest an entirely new perspective on the public sector, i.e. what it is and how it operates. In the existing literature there is a wide range of approaches to the analysis of government and non-market institutions and organisations, including public administration, public policy and policy implementation, political economy, public choice, organisational theory, neo-institutional theory, etc. No attempt is made here to cover all these different perspectives on the public sector, as such an ambition would go far beyond the format of this volume. This compact introduction to government and the public sector employs the principal–agent approach, applying it to the two classical perspectives on government, namely public administration (the rule of law) and public management (efficiency). What is new in this volume is the effort to base the understanding of government, its bureaux and agencies, as well as the state enterprises, upon game theory and the new economics of information, comprising *inter alia* the principal–agent approach.

Approaching the public sector in terms of the principal–agent framework leads one to see how transaction costs direct people to support government and its management of a public sector. The legitimacy problem of the modern state calls for constitutional government, or the rule of law. Understanding the modern state requires that one takes two fundamental considerations concerning government into account: efficiency and legitimacy. Both these objectives lead to the public principal contracts with a variety of agents in order to get the job done. Government may thus be analysed as a nexus of contracts. However, public sector contracting is not merely a replication of private sector contracting or market interaction. Public sector contracting has its specific features, which I will attempt to analyse below, especially the politics/administration separation, which can only be fully understood by means of the principal–agent framework.

I have divided the book into ten main chapters corresponding to the major themes in relation to government when analysed in terms of the economics of agency. All chapters were written for this volume, except that I have drawn on one published article ('Transformation and Future of Public Enterprises in Continental Western Europe,' in *Public Finance*

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*and Management*, 2002, Vol. 2: 47–66) plus a few review articles in *Public Management Review*. I have also drawn on an article written together with Florent Dieterlen ('The Mathematics of Management and Public Organisation: The Principal–Agent Framework,' in *Festschrift to Hannu Nurmi*, 2004, pp. 223–241).

This enquiry is the result of my teaching at Hong Kong University (in 2000 and 2002), at the National University of Singapore and at the Chinese University of Hong Kong (2003), where H. C. Kuan (Chinese University) provided a most stimulating environment for rethinking the art of government. I benefited especially from conversations with Ian Thynne (Charles Darwin University), whose knowledge of government was very helpful. Erik Verkooyen, André-Bruno Fischer and Daniel Martel (Dept of Political Science) contributed to the completion of the manuscript, and Sylvia Dumons (University of Geneva) assisted greatly in making the final version, correcting revision after revision without complaint.

*Jan-Erik Lane*  
*Geneva, November 2004*

## Introduction: the public and the private sectors

Every advanced society has three sectors: the public sector, the private sector and the third sector of voluntary non-profit organisations. The public sector comprises the general government sector plus all bureaux and agencies, including the central bank. The public enterprises are sometimes placed in the public sector and sometimes in the private sector, if organised as joint-stock firms. Principal-agent interaction arises in the public sector as one party, the principal, hires someone or a team of people, the agents, to get something done in exchange for remuneration.

The public sector consists of the services and the transfer payments of governments at various levels in the political system, as well as of the goods and services produced by the public organisations, by outsourcing or by the public enterprises. It comes with a price tag that must be covered by government taxation and user fees plus borrowing. Eventually, the costs of borrowing must also be covered by means of taxation.

The government sector consists of the following resident institutional units: all units of central, state or local government; all social security funds at each level of government; and all non-market, non-profit institutions that are controlled and financed by government units. This sector does not include public corporations, even when all the equity of such corporations is owned by government units. It also does not include quasi-corporations that are owned and controlled by government units. The economic aspect of the public sector is called 'public finance' and its size is measured for the 30 OECD (Organisation for Economic Cooperation and Development) countries by means of a system of statistics called 'National Accounts'. The Paris-based OECD publishes comparable public finance information every year. I shall employ this source to state an important distinction.

The general government sector consists of the totality of organisations which, in addition to fulfilling their political responsibilities and their role of economic regulation, produce principally non-market services or

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goods for individual or collective consumption, and redistribute income and wealth. The government sector includes central government or federal government, which tends to be the biggest subsector, at least financially.

The central government subsector consists of the institutional units making up the central government plus the bureaux and agencies that are controlled and mainly financed by central government. As the political authority of central government extends over the entire economy, it has the authority to impose taxes on all residents and non-resident units engaged in economic activities within the country.

The monetary authorities sector includes the central bank or the currency board and certain operations usually attributed to the central bank but, in some cases, carried out by other government institutions (or, in some instances, by commercial banks). Here we find the issue of currency, maintenance and management of international reserves – including those resulting from transactions with the International Monetary Fund (IMF) – and the operation of exchange stabilisation funds.

In the world of public finance there are two sets of countries which operate two different models for the public and the private sector. On the one hand, there are the welfare states with a mixed economy. On the other hand, there are the welfare societies, relying predominantly on the market economy. The delimitation of these two sets is somewhat arbitrary, as all countries have a public sector of some size. I shall draw the line at about 40 per cent total public expenditures of gross domestic product (GDP) for year 2001. Then the available data allows me to classify the following countries into these two sets (see Appendix):

- *Welfare states*: Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovak Republic, Sweden and Switzerland.
- *Welfare societies*: Australia, Ireland, Japan, Korea, New Zealand and the USA.

In both welfare societies and welfare states, difficult questions arise about public administration and management. Welfare states urgently need to address these questions, given their heavy reliance on the public sector. However, welfare societies should also address these questions in their search for public sector reform.

Corresponding to the separation of the public sector into three subsectors,

- government sector: allocation and redistribution
- public enterprises
- monetary authority

one must, in a traditional public sector, set up enquiries into four kinds of principal–agent relationships:

- governance of the bureaux
- governance of social security
- governance of the public enterprises
- making of monetary policy.

I will deal with the first three principal–agent relationships. That is not to say that there are not interesting principal–agent aspects of the making and implementation of monetary policy, which is one example of the general problem of public regulation. On the contrary, one may restate the two basic models of a monetary authority – Keynesianism and monetarism – as alternative models for the interaction between government as the principal and the Central Bank as the agent. However, the pros and cons of an independent monetary authority have been well researched recently. What opens a new perspective on the classical discipline of public administration, as well as giving the emerging discipline of public management theoretic coherence, is the application of the principal–agent approach to the government sector, its bureaux, agencies and enterprises or firms.

Thus, in any society one may make a demarcation between the public and the private sectors. This separation may not be crystal clear or neatly institutionalised, but it still exists. It is done in different ways in various societies. It is of profound significance however it is made. The public sector is the sphere of government, whether central, regional or local. The private sector is the family as well as the market and its firm organisations. The public–private distinction is a highly political one, as political parties go to elections on programmes to change the established division between the public and the private. No society can be either public or private, as all have a mixture. The public sector may be designated the ‘state’, but it gives the impression of a monolithic actor, which is quite wrong given the multiplicity of governments and authorities in the public sector.

The public sector consists of all the various activities of governments and their agencies. One may classify these into three categories: services – the provision of public goods and services (public resource allocation); transfer payments – income maintenance programmes (social security); and public regulation. The operation of these activities – allocation, redistribution and regulation – requires staff, meaning that governments must hire people and set up organisations. Thus, government faces two key problems that it must solve in public administration or public management: (1) how many employees to hire, and (2) how to organise these employees. I shall pinpoint the major changes in public administration and management that have occurred in the last 20 years, making it an interesting discipline in the social sciences. What I am referring to is the rise of New Public Management (NPM). I will discuss here the general model of NPM and in a later chapter

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return to country-specific applications when analysing public management policy.

#### **Need for public administration or public management**

In a well-ordered society the public sector has an impressive size, as there will be a fairly large set of public services, a decent set of social security programmes and a fair amount of public regulation of the private sector. The discipline of political economy deals with the politically highly sensitive question of *how much*, meaning the size of public resource allocation, the size of income redistribution and the amount of public regulation. The discipline of public management examines how the public employees are to be organised so that the job gets done. Various quantitative indicators have been developed in order to identify the demarcation line between the public and the private as well as to estimate the size of the public sector. One may employ different measures such as: the cost of the public programmes in terms of GDP; the number of public employees in terms of all occupationally active, and the number of laws and regulations for business.

These standard indicators give very different results and they must be used with caution. What they indicate is that the public sector in a well-ordered society ranges between 25 per cent and 60 per cent of GDP, in terms of expenditures as well as between 10 per cent and 40 per cent of those employed. Very few countries practice the extreme solutions of either a Manchester liberal society with a minimalist state or a Communist society with a maximalist state (Barr, 1993; Rosen, 1988).

We will not go into the key problem in political economy of discussing the pros and cons of the welfare society and the welfare state, since both require a public sector and consequently public management. The core interest in this volume concerns how government organises its employees into *teams* for service provision, transfer payments and regulatory tasks. The main approach I suggest is the principal-agent framework looking upon public management as a *nexus of contracts* between principals and agents at various levels of government.

Public management or public administration deals with how governments set up organisations of people, motivating them in the performance of programmes as well as monitoring and evaluating their performance and results. Governments may choose *in-house* or *out-of-house* provision, meaning that it may also contract with private provider organisations or private individuals. Public administration management includes planning, budgeting, steering, monitoring and evaluation. Theories of public management attempt to explain how public organisations work, their accountability, efficiency and fairness. It is both an empirical and a normative enterprise, as theories of public management try to explain alternative institutional arrangements in various countries but also state recommendations about management reforms, and their feasibility and desirability.

The political nature of public management cannot be denied, referring to the distinction between politics and administration. All public administration and management is conducted within a political setting where the goals and means of activities are politically relevant. Public management is not neutral administrative action but consists of the execution of public policies. The principal-agent framework underlines this feature, as the basic principal of public sector organisations is the population, or *demos*. Political leaders rely on organisations or teams of people to get the job done in the public sector. The key question in public management is which organisational model to employ for the public teams and the conduct of their operations given the omnipresence of strategy.

### **New Public Management: the general framework**

It is difficult to find one concise definition of NPM in the literature. The term NPM appeared in the early 1990s, and designated the ongoing public sector reforms in Anglo-Saxon countries. Since many countries have engaged in public sector reform one would like to identify the specifics of NPM in order to separate its key ideas from public sector reform in general. One must not assume that all public sector reforms during the last 20 years have been inspired by NPM. To identify what is distinctive about NPM I will first look at its rhetoric and then proceed to state two definitions, one *broad* and one *narrow* (Pollitt and Bouckaert, 1999; McLaughlin *et al.*, 2001; Hood, 2000; Thynne and Wettenhall, 2004).

#### ***Rhetoric of NPM***

The language of NPM is different from that of traditional public administration, as well as that of public policy. The key words may be listed thus:

- *Service to customers*: Public organisations have only one rationale, namely the efficient provision of services to citizens. All the effort in setting up and funding public organisations must be directed towards the accomplishment of concrete objectives, i.e. services.
- *Leadership or entrepreneurship*: Public employees who are responsible for service provision need to be empowered, meaning provided with discretion to find the best means of achieving objectives. The complexity of service provision requires innovation and flexibility. Public employees cannot be restricted by red tape.
- *Contracting*: The leaders of public organisations must have great latitude to contract with their employees or buy goods and services from outsiders. Running a public organisation is about negotiating, writing and monitoring contracts with insiders or outsiders.

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- *Governance*: A public organisation lives in a complex setting with other public and private organisations placed in a vibrant civil society. To accomplish goals, public organisations must recognise reciprocity and engage in networks of governance with other public and private organisations.
- *Re-engineering government*: Public organisations cannot be based on the traditional hierarchical and formal model of organisation, recommended in public administration. Front-line managers must be empowered. Policy advice should be separated from policy execution.

The key concepts in NPM were launched by practical people with an experience of business administration, but they have sources in academic reflection about the conduct of government bureaux and public enterprises (Hennessy, 2001). NPM comes in two versions. In a broad definition, NPM stands for public sector reforms that have been conducted in advanced countries lately, aiming at decentralisation and efficiency. However, in a narrow definition, NPM refers to a specific *governance model* that is entirely different from traditional public administration (Hood, 2000; Kettl, 2002).

### *Broad definition of NPM*

Public sector reforms have been conducted in all OECD countries since 1980. One may characterise them by enumerating the key ideas in many of them as follows:

- *Emphasis on outputs and outcomes*: In traditional public administration the rule-of-law emphasis leads to a focus on inputs. Thus, administrative law as well as finance laws and budgetary regulations deal with the resources of the bureaux and regulate the conduct of behaviour on the part of individual bureaucrats and professionals. NPM looks upon the public sector organisations from the output or outcome perspective. It underlines the performance of the bureau as a whole, as well as that of individual team members. By emphasising outputs and outcomes in the public sector, NPM moves away from the cost concern typical of traditional public administration. Instead of rules the concentration is on *value*, meaning the benefits that the implementation of public policies result in for society.
- *Productivity and effectiveness*: Although value is far from easy to measure in the public sector, it still exists for public services just as for private ones sold in the marketplace. When public services are not allocated through the market, it is difficult to identify and measure their value. However, they do have a value to citizens, meaning that one can ask questions about efficiency, either as productivity (internal efficiency) or as effectiveness (external efficiency).

- *Customer service:* Value derives from the appreciation of citizens or consumers with public programmes. Bureaux have no right to exist but must prove their existence through the value they create in society. Far from being immortal, public organisations have no intrinsic rationale but act under a rationality assumption deriving from the value they create for society.
- *Downsizing or economy:* Governments in the OECD countries have in general tried to reduce commitments. It is not only a matter of increasing efficiency but also the cutting back of oversized programmes. Thus, all three parts of the public sector – allocation, redistribution and regulation – have come in for cut-back strategies.
- *Deregulation or reregulation:* Traditional public regulation in the form of entry regulation has been undone in major regulatory reform, increasing entry and thus competition. However, the move towards deregulation has often been followed by reregulation, setting up a new agency to check product quality, i.e. product regulations. Anti-trust regulation is often stressed in public sector reform, speaking about the relevance of the ‘two Cs’ to the public sector: choice and competition.
- *Decentralisation:* Offloading government has often meant moving tasks from central government to regional or local governments. Devolution is considered an essential strategy in public sector reform, whether in federal or unitary states. One may wish to distinguish between decentralisation (from state to local government) and deconcentration (from central level to provincial level in the state).
- *Privatisation or public–private partnerships:* Hiving off public policies to the private sector is one strategy that governments have started to consider more and more. There is actually a full range of options available from complete privatisation to only public ownership and government activity. In the network model there are all kinds of public–private mixtures, including third sector organisations.
- *Contracting out:* There is hardly any limit to what can be contracted out in the public sector. Sometimes even the contracting out of services is done out-of-house, though much outsourcing may hollow out government and lead to the concentration of asset-specific knowledge in the private sector.
- *Leaner or flatter organisation:* The typical transformation of the structure of private firms has been accepted also in public sector reform. Thus, middle-level managers have been removed and lower-level managers have been empowered. The giant hierarchy is no longer the optimal organisational structure, neither for private firms nor for public organisations.

One does not find all these ideas in each and every country doing public sector reform. As will be shown in Chapter 10, there have been great differences between the countries in their reform profiles. Yet sometimes NPM

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refers to a more specific and coherent set of reform strategies which call for a radically different way of doing the business of government.

### *Narrow definition of NPM*

NPM as an entirely new philosophy of public sector governance harbours a few very precise ideas about how to get the job of government done. It relies on major ideas in economics, especially institutional economics and the economics of information, theorising the role of rules and incentives in organisations. Thus, NPM would employ the following market-inspired mechanisms:

- *Policy–provision split and purchaser–provider split:* Governments do many things, which is why it is essential to isolate the allocative part of governmental programmes. When governments produce goods and services, one may often ask whether the market could do it better. Allocative programmes must be broken out from regulatory tasks, and the provision of services can be done through outsourcing.
- *Contestability:* The separation of allocation from regulation and income maintenance opens up the possibility of market testing the production of goods and services. Since contestability is forthcoming when entry is open, governments should apply competitive tendering or bidding for all the services it wants to provide.
- *Contracting:* Using competitive tendering in allocation implies that government will employ its public procurement arm massively. Government becomes a contractor with alternative service providers, *contracting in* as well as *contracting out*. It may set up a purchaser–provider mechanism to handle an entire sector or a certain level of government such as a local government.
- *Incorporation:* Commercial matters in government are best handled through the employment of private law tools, e.g. the joint-stock company. Public enterprises are best run as incorporated businesses where the equity may be partially held by private partners. Any unit that engages in allocation and has an income or revenue stream can be incorporated, e.g. a hospital.

Agency theory and the economics of information predict that the use of the new market mechanisms in public management will enhance efficiency, as they mix rules and incentives in a more correct manner than traditional public administration. It remains to be discussed how the basic goal of rule of law in the public sector is to be satisfied by NPM in this narrow sense.

### *Theories behind NPM*

Although it is true that NPM was put in practice by practical politicians and business gurus, it remains the case that the ground had been well

prepared by new academic ideas. Let us mention the main origins of NPM within academia without pretending that they constitute a coherent source of inspiration. There were actually several sources of NPM unrelated to each other (Ashburner *et al.*, 1996; Pollitt, 2003; Kettl, 2000).

- *Public Choice*: This school broke most markedly with traditional public administration by underlining in an extreme manner the role of self-interests in the public sector with alternative groups of actors. If the public sector is populated by revenue-maximising politicians and budget-maximising bureaucrats, then is it perhaps better to offload most of the activity to the private sector? At least one would favour contracting out as the chief tool of government in order to reduce the possibility of Niskanen budget strategies from bureaux (Brennan and Buchanan, 2000, 2001; Niskanen, 2004).
- *Chicago School economics*: The theory about market efficiency was launched at the same time as scholars started to speak about government overload. Thus, the Chicago message could be applied all over the public sector, calling for cut-backs in order to restore markets. If markets are at any time efficient when left alone by governments, then it would be foolish not to rely upon them. When complete privatisation and deregulation was not feasible, governments could employ market-inspired mechanisms such as vouchers, the negative income tax, third-party access and workfare arrangements (Leube and Moore, 1986; Becker *et al.*, 1995; Coase, 1990; Solow, 1998).
- *The agency approach and the economics of information*: In the public sector the interaction between the key players tends to be a game between two parties that lasts longer than the quick buying and selling behaviour in the market. In traditional public administration the interaction between government and its bureaux was modelled by means of the rules about tenure, vocation and expertise through virtual monopoly. Principal-agent theory offers a better model of this dual interaction, while also recognising that agents tend to have the upper hand in this interaction, at least under the institutions of bureaucracy (Macho-Stadler and Perez-Castrillo, 1997).
- *Managerialism*: Private sector management tools have been recommended for the public sector ever since management was established as a subdiscipline of business administration. As a matter of fact, private management borrowed early quite extensively from Weber's theory of bureaucracy and Fayol's emphasis on formal hierarchical organisation. Thus, Taylor's scientific management in the firm was not much different from Wilson's approach to public organisation. However, private management has developed in an entirely different direction, away from hierarchy, formal organisation and in-house production. According to economic organisation theory, the firm is a nexus of contracts where the mix of long-term and short-term contracts is decided by considerations

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of the opportunity costs of alternative contractual arrangements of insourcing and outsourcing. Public organisation is a need for a public management policy which outlines what is to be done in-house and out-of-house, as well as how much discretion managers may use given the requirements of rule of law (Pugh, 1997; Pugh and Hickson, 1997).

- *Network society*: The opportunity costs of alternative ways of organising teams depend on the evolution of society and technological change. Hierarchies are not the most efficient forms of organisation in a post-modern society where information is easily accessible and storable. The implication for public sector organisation is to find a governance model which fits the theory of the networking society (Kooiman, 2003; Shy, 2001).

Jan Kooiman's *Governing as Governance* (2003, a continuation of his edited volume *Modern Governance*, 1993) contains a clear and systematic exposition of the nature of public administration and management in the post-modern society, taking the governance approach to its logical completion. I shall first outline the basic points in his perspective in this highly theoretical book and then state one major reservation of mine.

- Governing today is governance as interaction in various arenas between public and private actors. Governance takes place equally in political and social arenas. Hierarchical governance is of limited use in the post-modern society. This is basically the Dutch network model made all-encompassing over the entire public sector.
- Interactive behaviour is orientated by means of subjective elements such as images. Public administration and management is more concerned with interpretation than behaviour. Problem solving results from how actors perceive the situation and position themselves in relation to others.
- Co-interaction plays the major role in bringing about outcomes meaning that cooperation among actors and stakeholders is crucial. Co-operation is the basic medium of exchange between all kinds of actors involved in policy implementation; it is dependent on how the actors perceive the situation and identify opportunities of joint action.
- Interaction occurs in arenas of different degrees of complexity, from simple problem solving to institutional decision-making. In addition there is meta-governance, where one reflects on the norms that all forms of governing must obey. Governance includes the process of arriving at agreements about the norms to guide the governing process.
- Societies have to respond to a number of governance challenges arising from social complexity. Governability depends basically on co-governance, but governability shows varying degrees of diversity, dynamics and complexity depending on the combination of the open and closed nature of interactions at the intentional and structural level.

Two kinds of objection may be raised when the governance model is taken to its logical completion. First, one may ask how applicable the model is empirically: how much of governing in the post-modern society is authority and how much is collaboration? I am not convinced that all governing is reciprocity. Second, one may debate whether this model includes the most relevant elements in any form of governing: what is the role of incentives in governance? One does not have to have an economic mind to emphasise the role of incentives, which Kooiman almost entirely bypasses. Public administration and management is, in my view, first and foremost *strategy*, and incentives are crucial for determining the strategies of the players involved, whether the interaction is authority or reciprocity.

All the above theories paved the way for the arrival of NPM, underlining the relevance of market mechanisms and the irrelevance of central control over an increasingly complex society. Time was no doubt ripe for the propagation of these theories as the post-industrial society called for new governance structures. Yet these sources of academic inspiration of NPM are somewhat different: some have a special economic tone, whereas others are more sociological in nature. In the so-called 'NPM countries', public choice theory and Chicago School economics were of profound importance. In other countries, e.g. the Netherlands, the network model was more important than economic theory. NPM was conditioned not only by new ideas in academia but also by fundamental social changes, the coming of the post-modern society, the theory of post-modernity and the risk society (Beck, 2001).

### *Conditions for NPM*

Among the background conditions for the receptivity of the NPM philosophy I would like to underline the following:

- *Maturing of the public sector:* The twentieth century saw not only the rise of the tax state but also the coming of the regulatory state as well as the insurance state (Tanzi and Schuknecht, 2000). Government is present in society: allocative, redistributive and regulatory forms. Whether the public sector is measured by money, laws or employees, it is true that government is large in all OECD countries, especially so in the welfare states. It has become increasingly difficult for governments to pay for all their public policies. Since governments are more and more hesitant about running up deficits, they have to develop strategies that lead to more output with fewer resources. The question then becomes: Which public management policy is conducive to *value for money*?
- *Information revolution:* Large government operations such as education, health care and social security will be as much affected by technological change as private organisation. The potential use of computers is enormous in government where information is crucial, both in terms of

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quality and quantity. Public organisations can be managed with the full employment of the potentialities of the information revolution – the coming of *e-governance*. Organisational structure will be affected by the computerization of work processes, as tasks are redefined and new skills identified (Oliver and Sanders, 2004).

- *Globalisation*: Although the globalisation wave derives its force first and foremost from the global market economy and the information revolution, it has clear implications for government operations. Public policy and policy implementation are affected by policy diffusion such as deregulation, global public procurement and migration from one state to another. The governance of the global society through international organisations conditions national policy-making, favouring competition. For instance, one major issue in international governance is whether regional coordination bodies such as the European Union (EU) and the North American Free Trade Agreement (NAFTA) or international bodies such as the World Trade Organisation (WTO) can require complete and open competition for contracts in the provision of public services (Hoekman *et al.*, 2002).
- *Civil society growth*: It is true that the twentieth century was the period of the growth of government. The literature on the expansion of the public sector shows that government grew on an average faster than the private sector, especially during war times. Yet the market sector has also expanded in a phenomenal way, as measured in the sustained positive and often high growth rates in the economy. Thus, the private sector has increased its capacity to provide services, meaning that offloading public sector tasks to the private sector is often a serious policy alternative (Deakin, 2001).

There was a widespread belief in the 1980s and 1990s that public sector growth had to be halted. Some political parties receiving considerable electoral support took the stance that government should be reduced – *downsizing*. Running a government with the revolution in information technology opened up a challenge that seemed highly relevant as globalisation pushed ahead in the 1990s. The old image of a huge bureaucracy seemed outdated, as the idea of a small flat organisation producing services in a customer-oriented fashion replaced the large formal organisation. Partnerships between the public and the private were suggested as more innovative and flexible structures for government in a strong civil society. And public management policy was devised, reforming the public sector organisations in accordance with the notions of NPM: market testing, competition, customer service, leaner and flatter structure, as well as managerial entrepreneurship. Yet there is more to public management than only management. One must add the rule of law and its implications for the conduct of government operations. How can justice be safeguarded in government?

### Public management: merit and accountability

Public administration as a practical discipline for the governance of the state was founded on an antithesis that runs through all forms of public management, namely the tension between technical competence and political accountability (Ingraham, 1995; Natemeyer, 1978; Shafritz, 1997). Governments cannot implement their own policies for simple transaction cost reasons. Thus, they need various kinds of experts or agents with competence to put in practice government policies. At the same time, these agents must be accountable to the government, as they implement the objectives of government. If the proposed solution to this dilemma within public administration (neutral competence against political sensitiveness) in the form of a sharp separation between knowledge and values (administration versus politics) is not tenable, then how can public management combine these two entities: merit, on the one hand, and accountability, on the other?

One may outline the possibilities of combining competence and accountability by means of a simple  $2 \times 2$  table (Table I.1) using the well-known concepts of Max Weber (Weber, 1978).

The move to set up major bureaucracies in the modern state, such as with the Northcote–Trevelyan Act in the UK and the Pendleton Act in the US, may be seen as attempts to arrive at the ideal solution of both high competence and high political accountability (Hennessy, 2001). The idea of Whitehall is that the civil servants are recruited only on the basis of merit but they serve their ministers completely, according to the doctrine of ministerial accountability (Johnson and Libecap, 1994). Civil servants will not be replaced when political power shifts from one party to another, because whichever party is in power needs competent people to implement policy. However, the civil servants will be loyal to the actual minister in power. Despite the effort to eliminate patronage from the Washington bureaucracy the number of political appointees remains much higher than in other OECD countries, reflecting the legacy of the *spoils* institution.

When bureaucratic cohesiveness is high, then the bureaucracy may start running the country. Weber predicted that the complex modern society could not be run without the bureaucracy, but he was well aware of the dangers of bureaucratisation. Two forms of low political accountability were identified by him, either *Beamtenherrschaft* (centripetal bureaucratic

Table I.1 Merit and accountability

Merit	Accountability	
	Low	High
High	<i>Beamtenherrschaft</i>	Weber's ideal solution
Low	<i>Satrapenherrschaft</i>	Patronage

power) or *Satrapenherrschaft* (centrifugal bureaucratic power). The history of political authority is full of examples of both forms, e.g. bureau autonomy (Dunleavy, 1991) and bureau capture (Becker *et al.*, 1995; Becker and Becker, 1997). The introduction of NPM affects the balance between merit and accountability.

NPM suggests the use of market mechanisms in public organisations. The purpose is to increase both political accountability and technical competence, but the outcomes need not be the intended ones. Several studies report on unintended results, such as increasing patronage in the distribution of contracts with suppliers, and elimination of public sector competence in favour of private sector competence (hollowing out), as well as increasing power and prestige for managers (Massey, 1997; Greene, 2003; Sanger, 2003; Shichor and Gilbert, 2000; Lavery, 1999; Flynn and Williams, 1997; Seidenstat, 1999; Raphaelson, 1998; James and Rhodes, 2003; Rothery and Robertson, 1995; Graham, 1998; Milgate, 2001; O'Looney, 1998). Moreover, the rule-of-law framework of public management cannot be undone in a constitutional democracy. It may be regarded as a goal in itself or as a means to competence and accountability in the public sector. I will look on the requirements of the rule of law as restrictions on efficiency in the public sector. Thus, the aim of public management is to deliver public services, but the organisations that are responsible for doing so must operate in accordance with the rule of law.

### **Public administration and public policy: a contracting perspective**

Public organisations, authorities, bureaux, agencies, boards and enterprises increasingly face the demand for both transparency and efficiency. These are *macro demands* raised by the public at large and by the politicians. Often they surface in the deliberations of the governing bodies of public organisations, as well as in parliament. How, then, can the managers of public organisations meet these two challenges: transparency deriving from the rule of law (the public administration view); efficiency in the implementation of policies through outputs and outcomes (the policy perspective)? I suggest that this is to a large extent a matter for *micro contracting*, i.e. how the chief executive officers (CEOs) of these public organisations negotiate, write and enforce contracts with their employees that solicit a high work effort resulting in high quality and quantity outcomes.

The macro objectives of a public organisation laid down in policy documents and stated in public law can only be accomplished if there is micro management orientated towards efficiency within the organisation. The public policy approach underlines the relevance of the political process, resulting in the overall framework for the activity of a public organisation, or a set of public organisations when tasks are interdependent between several public organisations. Thus, it deals with legislation, budgeting and

ministerial decision-making. The public administration framework targets the rule-of-law consequences of the operations of public organisations, including transparency, publicness and the possibility of complaint and redress. However, getting the job done in a public organisation is first and foremost a problem of contracting with people, motivating them to work to the accomplishment of the goals.

Contracting, from a micro view of the organisation, involves two things: (1) selecting the CEOs and (2) hiring the employees within insourcing or contracting out with other organisations. The achievement of the above macro goals of the organisation depends critically on how a whole set of micro contracts are made, starting with the CEO and his/her chief group of managers and ending with the contracts with each and every one of the employees. The quality of administration and the extent of policy accomplishments depend critically on how the entire set of contracts is handled, from negotiation up to evaluation. However, as I will show, there are some systematic difficulties in contracting that beset public management. They are best analysed within the principal-agent framework. Figures I.1 and I.2 may be consulted in order to clarify the bargaining problem where the principal has convex preferences and the agent concave preferences over effort and wage.

Figure I.1 targets the key importance of the effort of the agent, whether he or she works within an old regime of public administration or a New Public Management regime. 'Effort' ( $e$ ) denotes all the factors which determine how employees or subcontractors deliver outputs ( $O$ ) with a specific value – benefits – to the community in exchange for remuneration, or cost including a wage ( $W$ ). Speaking generally, the principal would be interested in eliciting an effort that creates a positive benefit, meaning that benefits are higher than costs – the *gain* section in Figure I.1. And the principal would hardly be happy about a situation where costs are higher than benefits – the *loss* section in Figure I.1.

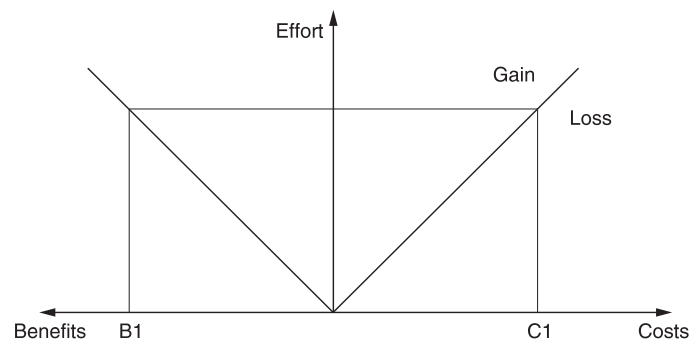


Figure I.1 Costs, effort and benefits.

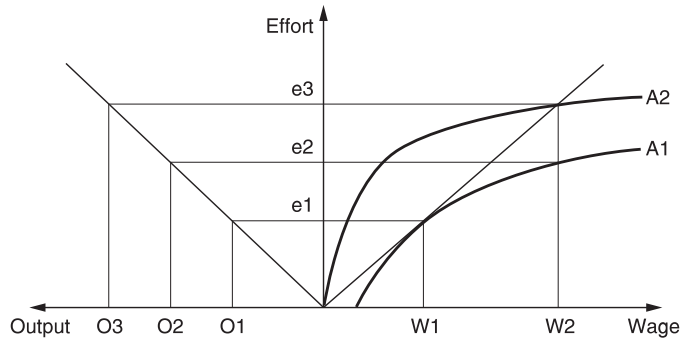


Figure 1.2 Wage, effort and output (principal's convex preferences deleted).

This brings me to Figure 1.2, where the two main solutions to the problem of creating value and minimising costs are outlined. Under old public administration, the principal would contract with one agent or team of agents for a wage  $W2$  against a promise of effort that would lead to an output of size  $O3$ . However, given the institutions of public administration, the agent would be tempted to shirk, delivering only  $O2$ . If the principal cannot correct this through monitoring, then he/she would be better off choosing  $W1$ ,  $O1$ . The agent promises one behaviour  $A2$  but delivers another behaviour  $A1$  – moral hazard.

Under New Public Management, the principal would steer away from moral hazard by creating a bidding process involving two different types of agents,  $A1$  and  $A2$ , with low and high effort, respectively. Thus, the principal would offer two different contracts, depending on the nature of the agent,  $A2$  receiving  $W2$  and  $A1$  getting  $W1$ . However, if there is *asymmetric* information, then the principal cannot separate the agents. Adverse selection entails that the principal would be extremely hesitant to offer  $W2$  to  $A2$ , because he/she really does not know whether he/she deals with agent  $A1$  or  $A2$  – the agent pretending. The principal may decide to offer all agents  $W1$ , because the expected value of the game does not warrant offering the salary  $W2$  – adverse selection.

In a well-ordered society (Rawls, 1995) the public sector results from the resolution of two principal-agent games: first the population as principal and the politicians as agents, second the politicians as principals and the service teams as agents. To strengthen the population as principal, so-called citizen's charters have been enacted in public sector reform.

### Citizen's charters

Charter programmes vary in content and purpose, serving the purposes both of New Right 'managerialist' concerns with rolling back of the state

and achieving greater 'effectiveness, efficiency and economy', as well as communitarian aims of reinforcing local self-government and enhancing citizens' sense of community as a counterweight to the remote central bureaucracies. Charters come in different guises. Even when there is central guidance involved in the launching of national charter programmes, there cannot be a rigid format even within single countries. Recognition of the citizen as a customer is something more or less taken for granted in many service sectors in many countries, but this recognition is by no means universal, and even where the position is well-established, it did not happen overnight. Charters challenge the traditional image that the consumer-citizen should accept what he or she is given.

Several countries launched charter initiatives to encourage those responsible for the delivery of such services to improve their standards of performance, to operate in a more transparent way, to be more responsive to the needs and expectations of their 'customers' and to improve their complaints procedures. The basic objective has been to promote the empowerment of citizens by raising their critical awareness of the quality of services and (in theory at any rate) letting those who are dissatisfied seek out other providers. An important consideration, reinforcing this consumerist consensus, has been the desire to get better value for taxpayers' money in the provision of public services. The charters form part of public sector reform that has dominated the bureaucratic reform agenda in the OECD group of countries from the late 1970s (Hood, 1991, 1995, 1997).

The OECD Public Management Service (PUMA) lists Western European charter examples from the UK, Belgium, France, Italy, Portugal and the Netherlands (<http://www.oecd.org.puma>): indeed, it is now true to say that the phenomenon is a common one in almost all member states of the European Union. In January 2001, the Swedish Government announced a 'Servicedialog' pilot project, including an effort to develop citizen's charters in government agencies (<http://www.servicedialog.nu/English/>). Charter initiatives are to be found in every continent. In a memorandum submitted to the UK House of Commons Public Service Committee in October 1996, the Cabinet Office's Charter Unit claimed that some 15 countries have implemented or are implementing programmes similar to that in the UK, including Argentina, Australia, Canada, the United States, Belgium and Singapore. Hong Kong has its Performance Pledges, Malaysia has its Client Charters programme (1993). In 1997, the South African Government published 'People First' and The Caribbean may be mentioned (e.g. Jamaica, 1994) as Namibia, Costa Rica and, quite recently, Samoa – with its Service Charter, first published in July 2002, according to Drewry (2005).

Some charters are predominantly law-based. The French 'Charte des Services Publics' from 1992 announced the intention of adding to the traditional French public service principles of equality, neutrality and continuity, new principles of 'transparency, participation and simplification'.

The goals of the French charter comprised taking account of service users' needs and explaining and helping them with procedures; encouraging participation by citizens, while cutting delays and simplifying procedures, as well as increased accountability by means of quality indicators, as well as more recourse to conciliation and arbitration with regard to disputes (Flynn, 2002).

The NHS version of the UK Charter has recently been reinvented in the light of experience with charters. The numerous local patients' charters, adapted to particular medical practices and hospital trusts, that can also be found on the web, indicate clearly the progressive trickle-down effect of the original, centrally driven, charter programme. In UK public law the ombudsman system has expanded. There has been a significant increase in judicial review of administrative action, following a major overhaul of the relevant procedures in the late 1970s with an Administrative Court. European Union law and the European Court of Justice have impacted on the legal culture. The incorporation of the European Convention on Human Rights into domestic law by enactment of the Human Rights Act 1998 has already had a considerable impact on law and administration. References to the Citizen's Charter, John Major's 'big idea' of 1991, are infrequent, as the charter initiative has undergone an incremental metamorphosis, explaining its apparent disappearance. In June 1998, the Blair Government revamped and renamed its predecessors' charter 'Service First'. Drewry states: "The heavy top-down pressure from the Cabinet Office in the early days, reflecting strong prime ministerial involvement, has become less necessary as the charter principles have become absorbed into the bloodstream of public services – and are taken largely for granted by both the producers and the users of those services" (Drewry, 2005:25). The development in NPM contexts of more contractual and quasi-contractual modes of service delivery has had implications, some with legal significance.

Citizen's charters have today often a local or sectoral orientation, as not much remains of the central government conception of Mayor. But the politics of charterism in the UK covers both the New Right emphasis upon consumers and the New Left underlining of community. And citizen's charters may be interpreted as instruments for structuring the basic principal-agent interaction in the public sector, government referring to the interests of the ultimate principle of public service, i.e. citizens.

### **Osborne's trilogy: a critique of the management philosophy of David Osborne**

Given the public attention rendered to Osborne's writings on public management, it is both timely and necessary to provide a critique of his key books with various co-authors. His message is a simplistic version of NPM without any foundation in organisational theory or rational choice.