

**Transparencies for PA 500**  
**Public Management and Policy**

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# Foundations of Government

Why is there government?

As Adam Smith argued

that government should protect "the society from violence and invasion of other independent societies"\* (p. 182) and protect as far as possible "every member of the society from the injustice or oppression of every other member" (p. 189) of the society. "Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way." P. 180

As Hobbes noted

"The life of man [becomes] solitary, poor, nasty, brutish and short."\*\*

As John Locke, argued

"the great and chief end...of men's uniting into commonwealths, and putting themselves under government, is the preservation of their property."\*\*\*

\*Adam Smith, *The Wealth of Nations*, Book V London J.M. Dent and Sons, 1977 (1776).

\*\* Thomas Hobbes, *Leviathan*, New York: Meridian Books 1963. (1651), p. 143.

\*\*\* John Locke, *An Essay Concerning the True Original Extent and End of Civil Government* (New York: Hasner, 1690), chap 9, sec 124.

# Policy and Administration

This definition rests on the distinction between policy and administration. Early proponents of the development of a "science of administration" distinguished between policy and administration. Woodrow Wilson (1856-1924), for instance, asserted that policy should be determined by political leaders of public organizations, elected officials, legislatures, and appointed officials, based on public preferences and other political considerations. Once policies were determined, they could be carried out, or implemented, by lower-level administrators working efficiently and automatically without further political considerations intervening.

\* Woodrow Wilson, "The Study of Administration," *Political Science Quarterly* 2 (June 1887).

## Public and Private

**Private**

**Self-interest  
Competition  
Entrepreneurialism  
Success implies gains**

**Public**

**SOP  
Compliance  
Conformity  
Gains are distributed,  
Risk is concentrated**

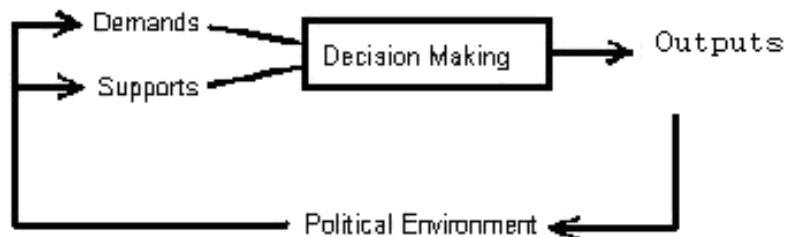
## Easton's Black Box Model of Political Life

David Easton's model of political life represented the first effort to apply to political analysis to the thinking of MIT's Norbert Wiener and others who emphasized the utility of the system models as representing an isomorphism between a cybernetic (and thus describable) model and natural processes.

Easton defined politics as a "A set or system of interactions defined by the fact that they are more or less directly related to the authoritative allocations of values for a society."

According to the Easton model, a system is a collection of elements that are related by observable recurring patterns.

A system is purposive in that it converts inputs (demands and supports) into outputs (decisions) through political actions (decisions, implementation actions, and so on) in the situation of a dynamic political environment. Government outputs produce outcomes that change the situation in a continuous fashion. Governments do not produce outcomes though, they only produce outputs.



## Classification of Outcomes

In an exchange situation, the results can be categorized as "outcomes" in terms of the distribution of benefits to the actors making the choices. Consider a simple exchange involving two actors. After the exchange, three possible outcomes exist:

A ZERO-SUM situation in which one side's loss is the other's gain;

A NEGATIVE-SUM situation in which both sides are worse off; and

A POSITIVE-SUM situation in which both sides are better off.

These categories can be extended to describe more complex exchanges with many actors.

## **Equity and Equality in Exchanges**

Equality refers to an equal distribution of shares.

Equity refers to the fairness of an exchange.

An equitable exchange is one in which both sides receive their due given some criteria.

## **Pareto-optimality**

Principle of Pareto-optimality: No reassignment of the outcomes can take place in such a way as to make someone worse off.

Named after Vilfredo Pareto (1848-1923)

## **Network Externalities**

“Network externality has been defined as a change in the benefit, or surplus, that an agent derives from a good when the number of other agents consuming the same kind of good changes.”

## Path Dependence

A relationship is **path-dependent** when the costs of changing the relationship exceed the benefits for remaining in it.

There are two significant problems introduced by path dependence:

- 1) The potential for sensitive dependence on initial conditions: determination, and perhaps lock-in, may take place as a consequence of small, otherwise insignificant conditions.
- 2) Path dependence may lead to a situation in which inefficient processes will be preferred to efficient ones if the cost of changing them is high.

## **Rational Actor**

Definition: A "rational actor" (rational agent) is a value-maximizing actor in the sense that, with respect to some arrangement of preferences that reflect the actor's values, the actor makes choices in such a way as to maximize (or optimize) expected outcomes.

## **Collective Action Theory**

The basic insight of collective action theory is that when dealing with collective goods—that is goods that are indivisible and jointly supplied—rational actors do not pursue the same strategies that they pursue with respect to divisible, individually supplied goods.

## **The Basic Insight of Collective Action Theory**

Parallel interests do not necessarily  
imply cooperative behavior.

## **Implications of Rational Choice Assumptions for Collective Decision Making**

"Rational" (that is, value maximizing) individuals in an egalitarian collectivist society will recognize that their contribution (that is, the product of their labors) as well as their benefits (that is, the amount of their withdrawal from society) will be divided by the total number of individuals in the society.

Because little proportionality exists between contribution and withdrawal, the "rational" individual will have an incentive to "free ride."

## **The "Free Rider" Problem**

A rational actor can be expected to "free ride" on collective goods, that is, contribute less than the average contributor and withdraw more than the average beneficiary, unless there are sanctions. Sanctions require a definition of equity and some political organization to define and enforce that definition.

## **Sub-optimal Outcomes in Collective Decision Situations**

A collective action problem is any situation in which, even when rational, value-maximizing, self-interested agents can agree on a desirable outcome, their behavior under circumstances of uncertainty cannot be expected to lead to this desirable outcome if they have mid-course incentives which would incline them toward "safe" but sub-optimal outcomes.

A "collective action trap" is any such "safe" but sub-optimal intermediate point.

# Principles of Distributive Justice

Compare the **communist principle** (articulated in the *Communist Manifesto, 1848*)

"from each according to abilities,  
to each according to need"

with the **socialist principle** (Article 14 of the 1977 Soviet Constitution):

"from each according to his ability,  
to each according to his work."

## **Adverse Selection and Moral Hazard**

In relations between principals and agents, the principal often relies upon indicators of success rather than success itself (**adverse selection**), while the agent directs attention toward the satisfaction of proxy measures rather than toward the success of the task itself. (**moral hazard**).

## Prisoner's Dilemma Payoff Matrix

	Prisoner 1 confesses	Prisoner 1 remains silent
Prisoner 2 confesses	I	II
Prisoner 2 remains silent	III	IV

What are the possible outcomes: (the "payoff matrix")

I #1 confesses #2 confesses  
both get 2 years (total= 4 years)

II #1 is silent #2 confesses  
# 1 serves 20 years,  
# 2 goes free (total=20 years)

III #1 confesses #2 is silent  
# 2 serves 20 years, # 1 goes free  
(total=20 years)

IV #1 is silent #2 is silent  
both get 6 months (total =1 year)

## Market Design

Why do we need any market design, much less good market design? The three top reasons are:

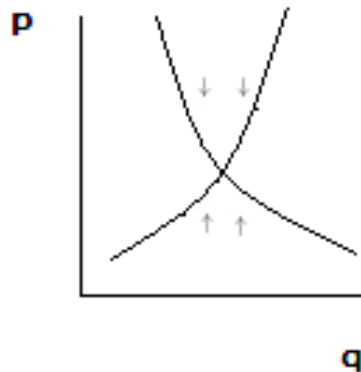
1. Incentives
2. Incentives
3. Incentives

Once parties have choices, it is critical to get the incentives to reflect the effects of the choices.

William Hogan

## Market Model

The exchange model describes a situation in which there is no central control, supply adjusts to demand, production adjusts to consumption, and price mechanisms are the means by which the automatic adjustment takes place. The value of goods and services is determined by the interaction of supply and demand, demand being explained in terms of the aggregate effect of the consumer behavior as rational, value-maximizing decision makers and supply being explained in terms of the aggregate effect of producer behavior. Under these conditions, the value of a good is the market



clearing price, that is, the price at which the quantity supplied is equal to the quantity demanded. When priced above this point, the quantity of the good supplied exceeds demand--there is a glut which tends to drive price down. When priced below this point, the quantity of the good demanded exceeds the quantity supplied--which tends to drive prices up. Coordination occurs not through the intermediation of some central authority but by way of

automatic adjustments reflecting choices made by individual actors.

## **The Fundamental Theorem of Welfare Economics**

If producers and consumers act as perfect competitors, that is, take prices as given, then (under certain conditions) a Pareto efficient allocation of resources emerges.

## Market Failure

Markets may fail to generate an efficient allocation of resources.

Why? Typically there are two answers--market power and non-existence of markets.

Markets can fail when monopolies act to limit the information available to the consumers and thus artificially restrict their choice.

Another reason is the problem of market externalities. Sometimes there are costs that are not internal to the decision making of the market but are real costs and are forced onto external parties—often society.

For either reason, market failure implies that some outside entity has to come in to solve this problem.

# Condorcet's Voting Paradox

The voting paradox was identified by the Marquis de Condorcet in the late 18th century. Collective preferences can be cyclic (i.e. not transitive), even if the preferences of individual voters are not. As a consequence, majority wishes can be in conflict—a paradox. The paradox is highlighted by the Condorcet method of voting. This method will fail to determine a winner in simple voting situation.

Take an example. Suppose we have three candidates, A, B and C, and that there are three voters with preferences as follows (candidates being listed in decreasing order of preference):

Voter 1: A B C

Voter 2: B C A

Voter 3: C A B

Note: The majority of voters (two thirds in each case) prefer A to B, B to C, and C to A.

## Arrow's Theorem

Arrow's theorem says that if the decision-making body has at least two members and at least three options to decide among, then it is impossible to design a social choice function that satisfies all these conditions at once.\*

\* The theorem is due to Kenneth Arrow who proved it in his PhD thesis and popularized it in his 1951 book *Social Choice and Individual Values*.

# Institutions

As Elinor Ostrom maintains, institutions are governed by rules that "are the means by which we intervene to change the structure of incentives in situations."\*

\* Elinor Ostrom, "An Agenda for the Study of Institutions," *Public Choice* Vol. 48 (1986), pp. 3-25 at p. 6.

# OSTROM DIAGRAM

## Categories of Goods and Services

	EXCLUDABLE	NON-EXCLUDABLE
	I	II
	private goods	common pool
SUBTRACTABLE	(eg.-- an apple)	(fishery)
	I	IV
NON-SUBTRACTABLE	toll goods	collective goods
	(household electricity)	(lighthouse beam)

An "excludable" good is one that has the property that a potential user can be excluded from the benefit of the good if he or she fails to meet some condition set by the supplier. A "subtractable" good is one that has the property that consumption of the good diminishes the supply available.

Based upon Vincent Ostrom and Elinor Ostrom, "Public Goods and Public Choices," in E.S. Savas, ed., *Alternatives for Delivering Public Services* (Boulder: Westview Press, 1977), pp. 7-14.

## **Principle of Fiscal Accountability**

Principle of fiscal accountability: All those who benefit from a good pay for it, and those who do not benefit from it are not forced to pay for it.

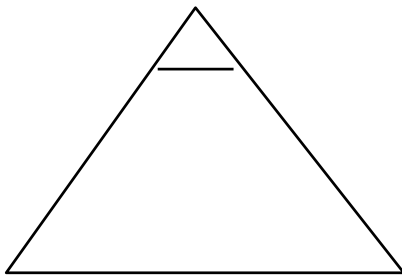
## **Principle of Fiscal Equivalence**

This principle maintains that there is a need for a governmental institution (agency, body, committee, commission, collective, boss, and so on) for every collective good with a unique boundary, so that there can be a match between those who receive the benefits of a collective good and those who pay for it.

## **The Principle of Equitable Apportionment**

No one beneficiary of a common pool resource has the right unilaterally to determine the formula for the allocation and distribution of the resource.

### Sectors in Hierarchical Society



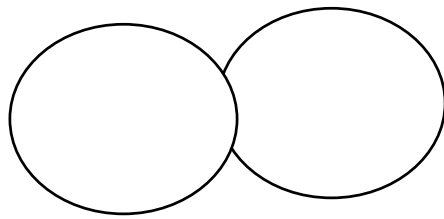
government sector

non-governmental sector

## Sectors in Contemporary Societies The Dual Model

public (government) sector

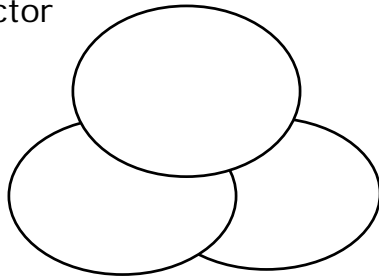
private sector



## Sectors in Contemporary Societies The Tri-sector Model

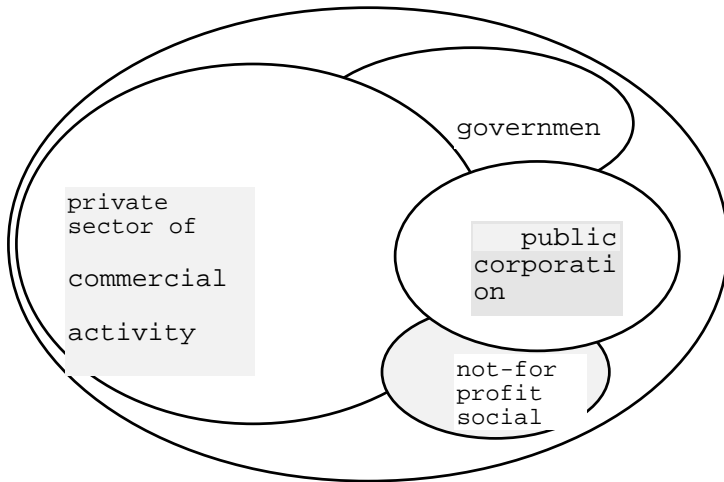
government sector

private  
sector



private sector non -commercial

## Sectors in Contemporary Societies The Civil Society Model



society

# Dynamics of Coalitions

One of the most fundamental constructions of competitive politics is the coalition.

- Coalitions may be defined as tactical combinations of individual decision makers that form in order to achieve a specific short-term goal.
- Coalitions invariably and specifically form specifically with respect to a perceived threat of loss that the individuals share. Coalitions are usually related to other coalitions. Frequently coalitions exist specifically to preempt or counteract other coalitions.
- Coalitions exist in the context of competition. Because parallel interests do not by themselves imply cooperation, actors cannot be expected to cooperate in order to achieve their common goals. But actors can be mobilized to subordinate their short-term interests to the longer-term interests of preventing another group of actors—an opposing coalition—from achieving its goals.

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