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2. Economism and public policy

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INTRODUCTION

A significant and consistent feature of the globalization debate is the contention that there now exists a series of non-negotiable external economic constraints on policy, which render certain policy choices ‘necessary’ in order for governments and workers to survive the forces of globalization. The argument usually develops that the globalization of economic activity exceeds the regulatory reach of national governments; simultaneously, the existing multilateral institutions of global economic governance are too weak to control this process; and thus global markets may effectively escape political regulation. Further, the exigencies of global competition impose a certain set of economic governance structures on national governments, which to resist or avoid runs the risk that nationally located economic activity will rapidly shift to other economic spaces with more favourable governance structures.

One crucial aspect of these new governance structures is the ascendancy of economic modes of thinking within the policy process. The term ‘economism’ is employed in this chapter to refer to governance structures where economic logic or economically inspired advice is institutionally embedded, normalized and held as necessary in the determination of policy choices. The concept comes from Marxist history and originally referred to the belief that the economic mode of production absolutely determines a society’s social, political and intellectual life. However, it has come to have a more specific contemporary meaning as the transcendence of economic logic in the development, implementation and evaluation of public policy (Teivainen, 2002). The characteristic of this process has been a shift beyond the normative position that public policy ought to be carried out on the basis of economic analyses, to one in which economic logic is actually entrenched within contemporary governance structures (Hay, 2004).

One example of this embedded economic logic is the widespread, international embrace of cost–benefit analysis (CBA) as a decision-making tool in policymaking. The irony for moral philosophers, like Wolff and Haubrich (2006), is that while philosophy has turned away from any theory

which assesses the value of actions in terms of the maximization of good consequences over bad, public policy decision-making is increasingly wedded to this hallmark of neoclassical economics.¹ The political power of central budget agencies in national governments is the driving influence behind many areas of public policymaking being dominated by CBA. In its textbook form, CBA is a basic form of consequentialism: all consequences can be and should be valued in a common currency (usually money). This is how governments often represent their decision-making, from the building of a sixth terminal at Heathrow Airport to the public funding of the anti-cancer drug Herceptin in Australia. Despite the voluminous literature discussing the technical deficiencies of the cost–benefit method, one guiding ideal remains: in any situation, there exists a public policy choice for which the ratio of benefits to costs is greater than the alternatives.

This is the choice that would be made by a ‘benevolent’ dictator; any actual policy decision that deviates from this choice demonstrates the inefficiencies of politics. Economism is the acceptance of imperatives of economic necessity, at both the micro and macro levels, as occluding or limiting alternative moral or democratic decision-making logics. The CBA example reveals the anti-politics heart of economism; politics is inimical to the ability of policymakers’ ability to implement the policies to ensure national economic spaces are competitive in the global economy.

However, this chapter steps above and beyond the economicist ideology and takes as its starting premise that any policy based on economism has both political intentions and political consequences, and that its proponents, in asserting ‘politically neutral’ policymaking, are essentially either misconceived or deliberately concealing political motivations. As Peck (2001, p. 447) argues with respect to economic necessity arguments in globalization: ‘contrary to the impression fostered by some globalisation ideologues . . . these developments are not naturally occurring, inevitable consequences of “the way the world works”. Instead, they are part of a sustained political project which is explicitly concerned to normalize and naturalize conditions such as free trade, flexible labour, public sector austerity, and low inflation.’

This chapter aims to show how basic economic understandings and concepts act as a foundation for policy analysis. However, within this exposition, I probe the extent to which there is a single or unique economic logic to be institutionally embedded and argue that within the straightforward, entry-level concepts of neoclassical economics which are embedded in policy discourses there are, in fact, many different policy choices that might be recommended. That particular economic ideas have been influential to the extent of becoming normalized is a function of politics, not inevitable or irresistible changes in the global political economy.

The term 'economism' has the advantage of distinguishing the political power of economic ideas from economics itself, and helps mollify protestors from within the economics profession who may complain that unsophisticated and elementary analysis is being used for political purposes in a way that does not always reflect what economists actually think. In showing that economic concepts and understandings have been influential in public policy, I have two ambitions. First, to show that many of the economic ideas embedded in governance structures are introductory, ideal-type textbook heuristics; they are often held by assumption, without reference to more sophisticated economic theory or detailed empirical work. The second ambition is a corollary of the first: to query the notion of a consistent set of policy options that might be labelled 'economic logic' and reveal how economic ideas have been used at different times to support very different policy prescriptions. For example, I show that the post-war Keynesian welfare state was constructed partly on the basis of a theory of public goods, just as the neoliberal reforms set in motion during the Thatcherite period were based partly upon public choice theory.

Economic ideas per se do not provide an automatic presumption for or against government intervention or the use of the market as a method of allocating goods and services. This is the corollary of pointing out that the transmission of ideas into government and their institutionalization is a political process, and that ideas themselves are being used in particular political ways. The journey from economic textbook to political project is one in which the ideas themselves are changed, moulded or interpreted for specific purposes. That is, the ideas themselves did not possess some disembodied power that captured the open minds of political agents in response to the requirements of globalization.

The chapter uses three main concepts from economics in the service of the ambition to illuminate economism and public policy. The first section looks at the concept of market failure and the policy prescriptions that follow from its recognition; the second section introduces the theory of public goods and discusses how this economic rationale was used to justify the construction of the welfare state; the third section probes the textbook notion of government failure as the logic behind many public policy reforms over the last 20 years.

MARKET FAILURE

Most economists use the achievement of Pareto efficiency as their goal in public policy design. According to this standard, a situation is efficient only if no individuals can be made better off without making someone else

worse off. 'Better off' and 'worse off' are understood in terms of the welfare of individuals, as opposed to groups, communities or societies. In these terms, Pareto efficiency refers to a utilitarian conception of what is valuable. It is often defined as the summation of the welfare of all the individuals in the society. Welfare can be measured either cardinally in terms of a common currency, or measured ordinally in terms of relative utility.

Importantly for understanding microeconomic analysis, it can be shown that, under certain idealized conditions, a system of free markets will lead to a Pareto-efficient outcome. This is known as the 'first welfare theorem' and was first demonstrated mathematically by Kenneth Arrow and Gerard Debreu; although equally important for assessing economic logic is that the result depends on several restrictive assumptions in the proof: for example markets exist for all possible goods, markets are perfectly competitive and transaction costs are negligible.

But what normative value is Pareto efficiency? There are many combinations of consumer utility, production mixes and factor input combinations consistent with efficiency. The first chapters of most public economic textbooks have a production possibility frontier; there are as many Pareto optima as there are points on this frontier. Crucially, each Pareto optimum corresponds to a different income distribution in the economy (see LeGrand et al., 1992). Some may involve great inequalities of income. So how to decide which Pareto optimum is the most desirable? Economists use the specification of a social welfare function to represent this decision. The social welfare function is a way of mathematically stating the relative importance of the individuals that comprise society, and this embodies value judgements about interpersonal utility. How then to make such judgements? This is academic ground that economists have tended to cede to moral philosophy. For example John Rawls, Robert Nozick and Amartya Sen all construct different arguments about the specification of social welfare functions. For our purposes here, there are two key points. First, even if markets can deliver Pareto optima, this is only a necessary and not sufficient condition for social welfare; and second, for economists the separation of questions of efficiency from distributional questions comes early in their education.

Although most microeconomics textbooks are predisposed to favour markets as efficient methods of allocating resources, this disposition is always accompanied by recognition of market failures. Indeed, beyond most introductory undergraduate classes this is the starting point for economic analysis of public policy. For example, the UK's central budget agency, the Treasury, produces a 'Green Book', which is the manual for the UK Government Economic Service and contains a series of justifications for public policy in terms of market failures (HM Treasury, 2003, Chapter 3).

Market failure is a broad concept for a variety of critiques of markets in economics terms: it refers to a series of factors that may result in pure market solutions failing to be efficient. This is an important point for appreciating the role of some economic thinking in policymaking: the efficiency advantages of markets are contingent upon certain key assumptions. I set out the main ones below under separate headings and suggest that they may all be doubted. These doubts provide the economic logic behind many public policies: governments should intervene to correct market failures in the economy. More detail on any of these market failures can be gained from most public economic textbooks (for example, Stiglitz, 2000).

Before proceeding it is worth noting that the notion of market failure contains the implicit assumption that markets take primacy over other forms of economic organization. These are pre-existing ontological entities or natural properties of the world. Government intervention is secondary, and only justified in terms of the extent to which it corrects market failure, that is, the extent to which it can help markets work and function. Further, there is nothing in the concept of market failure to answer the following question: how bad do the violations of the conditions necessary for Pareto efficiency have to be before an alternative means of delivery would be an improvement? That is, at what point is it efficient for government to stop correcting the market failure and consider some other non-market, allocative means. This is an important gap in microeconomics and means that economists will tend to frame policy analysis as the correction of market failure rather than a positive endorsement of something else.

Externalities

The result that markets deliver Pareto-efficient outcomes assumes that the social cost and benefit of any activity is the aggregation of individual or private costs and benefits for that particular activity. So the social cost of producing motorcars is the sum of the costs to each firm producing motorcars in the economy. An externality is any situation where this does not hold; where the sum of private costs diverge from the true social cost and/or the social benefit from the production and consumption of a good is greater than the sum of the private benefits. This occurs when the actions of one individual affect others but where that individual does not bear the true costs nor reap the rewards of their actions upon others. Pollution emitted by a factory that spoils the surrounding environment and affects the health of nearby residents is an example of a negative externality. Another common example is people deciding to use motor vehicles at certain peak times, leading to traffic congestion. An example of a positive externality is the effects of a well-educated labour force on the productivity of a

company, or perhaps more frivolously the decision to use deodorant on public transport.

Market prices can only reflect the actions of individual consumers and firms; and these agents only act on the basis of private costs and benefits. This means that market prices, consumption and production decisions will be on the basis of private costs and benefits. Market outcomes will thus be inefficient as too much of an activity will occur which has a negative externality, that is, firms underestimate the full social cost of their actions as in pollution-creating production; and too little of an activity which has a positive externality, as in the case where individuals do not account for the total social benefits of acquiring education.

Failure of Competition

The first welfare theorem requires competition in order for the invisible hand of the price mechanism to allocate goods and services efficiently. For this to be the case, there must be no monopoly, oligopoly or monopsony in any product, factor and capital markets. In addition, firms are price-takers: no firm controls a sufficiently large enough share of the market to directly influence market prices.

There are a number of good reasons why competition tends to fail against this standard. For example, barriers to entry for potential firms may exist. If there are increasing returns to scale in production, then already-established large firms can always produce more cheaply than new entrants. This is why there are so few mass production car companies in the world. Alternatively the barrier to entry may be the result of control of some technological standard, as was the case with Microsoft and the Windows operating system prior to the legal ruling that the company was acting anti-competitively in the United States. Further, transportation costs may limit competition (especially in the personal services sector of the economy), which may result in spatial monopoly. In terms of market failure, lack of competition can lead to less of the good or service being supplied, and at higher price than the Pareto-efficient level.

Public Goods

These are goods which it costs little or nothing for an additional individual to enjoy the benefits of (a property of non-rivalrousness in consumption) and yet it is very costly to exclude any individual from using the good (non-excludability). A market will provide too little or nothing at all of a public good. A potential supplier will face full cost of production but users cannot easily be charged or have no incentive to pay – the so-called ‘free-rider’ problem.

The classic example of a nearly pure public good is national defence: you cannot defend the vulnerable border regions of a country from foreign threat without also simultaneously defending everyone else that lives within the borders. The inability of potential providers to exclude people who refuse to pay from nevertheless consuming and benefiting from an expensive public good usually means that very many of the consumers of the good will act as free-riders and choose not to help pay for its provision. Consequently private production of the good or service may prove unprofitable, and the good or service thus may not be provided at all by the free market even though everyone would be better off with some positive level of production of the good in question.

Information Failures

For goods that are infrequently purchased, or require prior experience or knowledge to enjoy the benefits of, or which have a complex set of characteristics, consumers may be ignorant in some degree. This means that the price at which they are willing to buy or the amount they wish to buy may not represent a correct estimation of the benefit to them. Used cars are a classic example of such information failures. In such cases, the price in the market will not necessarily achieve Pareto efficiency in production and consumption for a given initial income distribution.

The more general point is that individuals may not be in a position to make rational choices. The rational actor, *homo economicus*, is axiomatic for models in neoclassical economics. Most other social sciences start from the position that individual agents do not have a clear, fixed and consistent set of preferences that they attempt to maximize the satisfaction of. Neither can agents be assumed to have the correct model of the world that predicts accurately the link between actions and consequences. However, for economics the concern is that once individuals or firms are seen as non-rational, bounded rational or irrational, the result that markets will deliver Pareto optimality cannot be assumed to hold.

Immobility and Time Lags

The first welfare theorem requires the whole economy to be in equilibrium simultaneously rather than just any single market; yet in the model as well as in practice, a single change in demand in one market can send a ripple through the economy via a set of interdependent markets. There is no economic theory to suggest how prices readjust to equilibrium nor how quickly. It is assumed that prices will readjust to ensure that each market is in equilibrium. But consider the transmission from product to factor markets in the

case of dental services. An increase in demand for dental services increases the demand for dentists' time, which can only be satisfied to a limited extent by the existing number of trained dentists through overtime or reduction in holidays. This will lead to an increase in the wage rate for dentists that will encourage more people to train as dentists, or perhaps some migration. However, the dental profession requires four years of training prior to being an approved dental practitioner. Further, for reasons of family, friends, housing costs and government regulation, dentists may not respond to changes in relative wage rates inter-regionally or internationally. This factor of production is immobile to some degree. Thus increases demand for certain services may take several years to ripple through the economy and arrive at an efficient equilibrium again. It is relatively easy to imagine these sorts of cases for many sectors in the economy, and thus immobility and time lags become an important aspect of market failure.

Incomplete Markets

A complete market economy would provide all goods and services for which the cost of provision is less than the benefits derived by potential consumers. Where markets are not complete the result that markets lead to Pareto efficiency will not necessarily hold. Markets may be missing and incomplete due to lack of information or asymmetries in information between potential buyers and sellers. This is sometimes expressed in terms of the principal–agent problem. The market for insurance is a good example: an insurance firm (principal) may not offer insurance to low-risk customers (agents) that would be willing to pay more for the insurance than it costs to provide it, because it cannot recognize low-risk agents or because it fears offering insurance to bad-risk agents. This is a problem of adverse selection (the principal cannot observe the type of agent). There exists a market exchange between buyer and seller that would improve Pareto efficiency that does not occur because of poor information. There is also the problem of moral hazard, where the principal may not be able to observe the behaviour of agents. In insurance terms, a firm may not insure individuals because it cannot observe how they will behave post-insurance contract. That is, will they start acting differently because they are insured? The problem of moral hazard is frequently raised in terms of health policy, where arguments are made that health insurance can promote demand for 'lifestyle' health care services, such as cosmetic surgery, which drains resources from cases of genuine medical need. This concern may lead to a less than efficient number of insurance contracts as companies raise prices to cover for the risk of extra claims, which reduces demand for insurance and potentially leads to missing markets for certain forms of insurance.

Different governments in justifying different public policies have variously used the six market failures described above. They are part of a consistent logic to the extent that they share the objective of improving the efficiency of markets, but beyond that each failure can be used as the basis of a whole suite of policy instruments from direct provision of a good for which there is a missing market (for example health care in certain countries) right through to indirect regulation (for example administering sub-legislative industry agreements about trademark standards to ameliorate problems of information failure). There is no determinate logic from the identification of a market failure through to a particular public policy prescription. One of my aims in this chapter is to show that not all economic concepts lead inexorably to neoliberal policy prescriptions, and indeed much economic analysis though predisposed to certain, broad types of solutions is not quite as determinate or relentless as is sometimes assumed. The next section focuses in some detail on the theory of public goods because: (1) it is a clear example of how the notion of a market failure can be used to support a whole set of policy proposals; and (2) in a particular case, the market failure logic has been used to justify an extensive welfare state.

PUBLIC GOODS AND POLICY SOLUTIONS

The simple version of the theory of public goods noted above suggests a significant social problem for market allocation methods. Nevertheless, various social arrangements and institutions have evolved to encourage the provision of public goods. For example, the non-profit or third sector of the economy devotes considerable effort to the provision of public goods financed by voluntary contributions that are motivated by appeals to duty or conscience. Alternatively, voluntary contributions may also be gathered from those people most intensely and deeply concerned about the particular social need being addressed, or from those who may be less beneficent but can be shamed into it by informal social pressures that withdraw status and respect from people identified and stigmatized as free-riders.

In addition to these non-profit approaches, the provision of 'impure' public goods may often be handled through ordinary market forces. These are goods that have one or other property (non-rivalrousness or non-excludability) to some degree. A frequently discussed example in economics textbooks is fire protection and the feasibility of fee-based private provision. For Stiglitz (2000), fire protection is similar to a pure public good in that the marginal cost of covering an additional person is very low, as most of the time firefighters are not engaged in fighting fires but are waiting for calls. Protecting an additional individual has little extra cost. However,

the ease of exclusion for fire protection is similar to that of a pure private good. Indeed in many rural and remote areas around the world, fire protection is by voluntary subscription. However, in urban areas buildings without fire protection may benefit from their proximity to buildings which are insured; that is, for the fire service to protect insured buildings requires them to put out fires in uninsured buildings because of the risks they may pose (see Carlson, 2005, for a discussion of the Great Fire of London). This situation is more difficult to solve in a private market.

It should also be noted that at least a partial provision of public goods often occurs when there is a single organization (or a rather small group of persons) who feel they will benefit from a particular public good to such an unusually large degree that it is worthwhile for them to go ahead and just pay for the whole thing while ignoring the many other small-time free-riders as irrelevant. Thus, mining companies in remote areas of Australia have invested heavily in infrastructure for their immediate commercial purposes, but the road, rail and port developments have benefited other economic activities as well.

Nevertheless, the classic solution to the problem of underprovision of public goods has been government funding – through compulsory taxation – and government production of the good or service in question. Although this may substantially alleviate the problem of numerous free-riders that refuse to pay for the benefits they receive, it should be noted that the policy process does not provide any very plausible method for determining what the optimal or best level of provision of a public good actually is. When it is impossible to observe what individuals are willing to give up in order to get the public good, how can policymakers assess how urgently they really want more or less of it, given the other possible uses of their money? There is a whole economic literature dealing with willingness-to-pay methods and contingent valuation techniques to try and divine such preferences in the absence of a market price doing so, but even the most optimistic proponents of such devices tend to concede that public goods will still most likely be either underprovided or overprovided under government stewardship.

Another line of economics argument is that where there are problems with the market mechanisms, these are not really cases of market failure at all but rather the absence of clearly specified and enforceable private property rights (Cheung, 1978). For example, the broadcasting of television programmes used to be seen as a public good: public television stations like the British Broadcasting Company (BBC) transmit to the whole of the UK, so that no one can be prevented from tuning in, nor does any extra person doing so reduce the amount of viewing available for subsequent viewers. However, this form of broadcasting was adopted not because of anything intrinsic to the market of television broadcasting, but because, with funding

from licence fees, there was no need for exclusion. With the advent of satellite broadcasting, there are now several methods of exclusion: pay per view or monthly subscriptions. The point is that public goods are only public goods because they are provided as public goods; public goods or externalities only persist in the absence of markets. However, such a point of view does illustrate the indeterminacy in the theory of public goods: can all public goods, following the introduction of property rights, become private goods? The answer is contingent on the current state of technology.

Whilst the theory of public goods can support government intervention, it does not exclusively do so. Indeed, the problem of public goods admits many different types of solution. Thus although notions of economic necessity, economic logic or market rule are properly represented in the political economy literature as part of political ideology, it is proper to note in this chapter on economism that the economics discipline itself would not recognize such definitive, immutable and determinant logic. The subject allows very different views on the balance between state and market provision and the efficient design of public policy. For a more detailed exposition of this point, consider the theory of public goods as a justification of the welfare state.

Utility interdependence is the term economists use to describe a 'caring' externality. By assumption, each person has a set of preferences that ranks alternative outcomes; the caring externality – utility interdependence – arises when the well-being of other people enters into an individual's preference schedule. For example, I may obtain a higher level of utility by giving money to the destitute than from satisfying some other preference. This means that if I am currently spending the money on that other activity, I will raise my utility by instead donating the money to the destitute. However, complications to this analysis of a basic donor preference arise if acts of charity are a public good. Many more people than I will care about the fate of the destitute, but their knowledge of my charitable intentions may lead them to keep for themselves what they otherwise would have given, that is, to free-ride on my benevolence. If each individual in a society followed the same logic, then nothing would be done for the destitute.

In the words of Milton Friedman (1962, p. 190):

It can be argued that private charity is insufficient because the benefits from it accrue to people other than those who make the gifts . . . I am distressed by the sight of poverty; I am benefited by its alleviation; but I am benefited equally whether I or someone else pays for its alleviation.

The well-being of any agent whose preferences are utility interdependent may be lower than it could be. If an agent knows that others would refrain from giving if she donated, that is, they would free-ride in satisfying their preference for poverty alleviation on her donation, then she may decide, in

terms of maximizing expected utility, to use the money for another purpose. The overall result of this kind of logic is that the amount of charitable giving is suboptimal. This is the case for government redistribution or a welfare state. For if charitable contributions were compulsory, then not only would the position of the destitute be improved, but also donors would be brought to a higher level of utility, that is, their preference for the alleviation of destitution would be satisfied at a higher level.

The theory of utility interdependence is advanced by some as a justification of the post-war welfare state. For example, consider the health economist A.J. Culyer (1980, p. 65):

The very existence of the Welfare State is evidence for the proposition that specific caring exists, for if individuals did not care for one another then no externality would exist and there would be little reason for collectivist action.

This argument conceives of the welfare state as a kind of social contract. Without compulsion, as explained above, individuals who 'care' are left at a lower level of utility than is possible. The social contract welfare state provides a solution because everyone agrees to be compelled to contribute, because everyone is so compelled. This welfare state is justified because it eliminates the problems of caring externalities.

GOVERNMENT FAILURE

Some economists believe that even with good intentions governments seldom get their policy application correct. They can tax, control and regulate, but the eventual outcome will be a deepening of the market failure or, even worse, a new failure may arise. Market failures may provide a rationale for public policy intervention, but there are good reasons to believe that public policy interventions will actually reduce efficiency relative to the status quo, that is, no intervention level. Those reasons usually come under the broad heading of government failure.

Public choice has been concerned with the application of economic reasoning to the study of politics, using in particular the idea of *homo economicus* or the rational agent to explain the behaviour in the public sector, and the extent of the problem of government failure in the delivery of services in line with citizens' preferences. Public choice as a theoretical perspective has been closely associated with the gamut of institutional reform and public sector restructuring under the broad rubric of the 'new public management' (NPM).

In economics, an incentive is any factor (financial or non-financial) that provides a motive for a particular course of action, or counts as a reason for

preferring one choice to the alternatives. Public choice theory is essentially about different incentive structures faced by public sector employees compared to private sector counterparts, within the guiding postulate of instrumental rationality. The absence of (significant) competition in the provision of government goods and services has the same deleterious effects on efficiency as it does in the market failure story. For public choice theory, the key point is that the absence of competition is the norm rather than the exception in the public sector. Indeed, just as neoclassical economics analyses the deadweight welfare losses of monopoly, so monopolies in public service markets are equally efficiency-reducing as bureaucrats have little incentive to keep costs down or introduce innovations in service delivery. Compounding the lack of competition are the lack of a threat of bankruptcy and the ability to secure government subsidies, which mean that public sector organizations do not have the incentive to respond to changes in the preferences of citizens whereas private sector organizations are bound to respond to shifting preferences as expressed in changes in relative prices.

Monopolies need not necessarily have adverse consequences so long as the behaviour of bureaucrats can be easily monitored and controlled. However, for public choice theory there are no unambiguous indicators of performance in the public sector. A key component of public choice approach is that only public officials know the true cost of delivering a government good or service that is desired by the political sponsor. It is therefore easy for bureaucrats to persuade politicians to allocate more money than is necessary for a particular task. This is the standard principal-agent problem of asymmetric information; however, the possibility of solving this with a well-designed contract is lower in the public sector than the private sector for several reasons.

In terms of economic theory of optimal contract design, the starting point is that any measure of performance that reveals information about the effort level chosen by the agent should be included in the compensation contract. In the public sector, due to the complex nature of its activities and the multiplicity of objectives that public policy often seeks to achieve, there is rarely a measure that provides feedback on the performance of an individual agent. This problem exists for relative performance evaluation as well – measurement relative to other, similar agents, so as to filter out some common background noise. Indeed, extant measures of public sector performance tend to be at the team or organizational level; it is impossible to ascribe the output of hospitals, for example, to any particular agent. These are complex production processes that do not resemble Fordist production lines.

The optimal intensity of incentives in economic theory depends on several things, including the precision with which the desired activities are

assessed and the agent's responsiveness to incentives. The more compensation varies with effort, the better the incentives for the worker to act in a certain way. This is easier to implement in terms of private sector firms but more difficult in the public sector, not least because of the difficulty of monitoring; any high-powered incentive scheme requires costly monitoring to the point where any putative advantages in improving efficiency may be negligible relative to the total costs of monitoring. The general point is the lack of potential for high-powered incentives for agents in public sector organizations. Without incentives that are strong enough to change significantly the behaviour of agents, principal-agent problems persist and government failure is endemic.

There is a presumption in public choice theory that the problem of coordination and control grows disproportionately with organizational size. For the public choice analysis, the public sector is characterized by large inflexible bureaucracies that are capable of producing significant quantities of outputs often at impressive speed, but lack the deftness to respond to changing circumstances or shifts in citizens' preferences. The standard Weberian bureaucracy that pervades most public sector organizations mis-aligns the incentives facing public sector employees toward rule-following in the mass production of standard goods and services rather than the tailored delivery of public services to satisfy citizens' preferences.

There is an enormous and still growing literature on NPM (see for example McLaughlin et al., 2001 or Boyne et al., 2003 whose broad contours follow from the public choice analysis of government failure). Although the term 'NPM' suffers from a degree of concept stretch, Hood (1991) sets out some broad reformist principles in which the public choice heritage can be clearly observed. The first is that the focus of public sector reform should be on structural reorganization rather than policy. It is the structure of the public sector that fails to provide adequate incentives for public sector organizations to respond to citizens' preferences for government goods and services. The provision of public services should be made more competitive, both between public sector providers and between the public and private sectors. Contracting out, quasi markets and separation of the questions of who pays (public finance) from who provides (public provision), are all hallmarks of NPM. They follow from the government failure logic and the objective of greater efficiency in particular. As discussed above, individual contracts in the public sector will generally fail to provide efficiency-enhancing incentives, but the public choice view is that increased competition in the provision of public services will.

A second public choice perspective is a stress on performance evaluation. Public sector organizations should be forced to provide more information on their performance. The argument is that this will move power, in terms of the

control of information, away from public service agents toward different principals such as politicians, academics, pressure groups and the public at large.

The third major type of reform in the NPM agenda is disaggregating large multifunction public bureaucracy into several single-function agencies. The reasoning is that performance becomes more visible with different tasks attached to different publicly visible organizations; some of the problems of specifying multiple and potentially conflicting objectives in a single contract are mitigated as separate contracts can be specified for each of the smaller agencies; smaller free-standing 'firms' can then compete more effectively for market share in the public services market.

CONCLUSION

The term 'economism' has been used here to refer to the institutionalization and normalization of economic logic in public policymaking. It has been adopted as a term here partly because it helps to distinguish the political power of economic ideas from the academic discipline of economics. This is important in highlighting that the economic logic that is in the ascendant is not necessarily representative of contemporary economic theory. Indeed, the economic logic that is embedded in policymaking is the outcome of an explicitly political process.

There is nothing obviously normal or natural or commonsense about economic prescriptions; but alternatively neither is economic reasoning always unique in its policy prescriptions. I have tried to show that many of the influential economic ideas are introductory, ideal-type textbook heuristics; they are often held by assumption, without reference to more sophisticated economic theory or detailed empirical work. The journey from economic textbook to political project is one in which the ideas themselves are changed, moulded or interpreted for specific purposes. Additionally, similar economic ideas have been used at different times to support very different policy prescriptions. For example, the welfare state has an intellectual basis in, *inter alia*, a theory of public goods, just as the NPM reforms in many OECD countries since the 1980s have been justified in terms of, and drawn from, public choice theory.

NOTE

1. Henceforth I will use the term 'economics' to refer to neoclassical economics. Although this fails to recognize the heterodox traditions in economics, it is justified by the dominance of the neoclassical paradigm in economic analysis of public policy.