

# Institutions and Policy Analysis<sup>1</sup>

by

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## Summary

Institutional analysis is associated with the work of Buchanan, North and Williamson. It lays stress on the constitutional arrangements for the conduct of commerce and property rights. Institutional analysis focusses on transaction costs and their effect on organisational efficiency. In recent years, the work of Dixit and Horn has drawn attention to the potential in policy making and bureaucratic organisations for such an approach. This paper reviews the work of these authors in this area and outlines its application to a strong feature of the Australian and New Zealand economies - commodity marketing boards. It is suggested that marketing boards are a form of semi-government organisation that minimise certain transaction costs that would otherwise have to be carried by central government. It is pointed out that the particular form of organisation legislated for both in Australia and New Zealand transfers the significant cost of monitoring the activities of such boards to the producers themselves with consequent weakening of any control relationship with the legislature which created them.

**Key Words:** Institutional environment, transaction costs, policy formation and implementation, marketing boards.

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## Institutions and Policy Analysis

### Introduction

With the visit of Oliver Williamson to Sydney earlier this year there has been renewed interest in the role of institutions in the policy making process. Earlier work by Williamson (1975) focused on the governance structures of the private sector, but more recent literatures have widened the analysis to public sector organisational problems (Horn 1995, Dixit 1996, Sandiford and Rossmiller 1996). The institutions literature focuses on the role of transaction costs in human exchange and how alternative organisational structures might help reduce such transaction costs. This change has reduced the emphasis on market failure analyses of the policy process and instead directed economists' attention to alternative means and structures for delivering policy in the real world. This paper is concerned with the role of transaction cost analysis in the policy making process and gives some illustrative examples of its application drawn from published literatures.

### What Institutions?

In this subject area, institutions is a very wide term that encompasses any organisational structures that humans agree on that will allow people to live in harmony and without conflict. In the realm of policy, the institutions of government include the legislature (parliament), majority rule, party systems, a free vote, state legislatures, and regular elections. To carry on the work, another set of institutions have grown up to execute the wishes of the legislature - bureaucracies, state-owned enterprises, the courts, and laws governing conduct of commerce. Within the latter are the institutions created around the law of contract and the establishment of property rights. Within agribusiness, perhaps the most powerful institution is still the ownership of land in fee simple - a property right sanctified by law in Australia and New Zealand since 1850 (the Torrens system of land registration).

Institutional analysis recognises a difference between operational and constitutional levels of decision making (Johnson, D.B., 1991). The operational level consists of decisions made within a given set of already existing and broadly accepted constitutional rules. The constitutional level is where the rules of the game are established including the rules for the application of property rights. These constitutional rules are thought to be established in an atmosphere of conceptual impartiality because the future effects on individuals cannot be foreseen (Dixit 1996, p.13). Once established, they change only very slowly, but sometimes cataclysmically. In between such times, individuals/corporations/governments operate in a relatively unchanging institutional environment and can make operational changes in policies, revenue collection and so on (incrementalism).

Davis and North (1971) call the set of fundamental political, social, and legal ground rules that establish the basis for production, exchange and distribution the *institutional environment*. Arrangements between economic units that govern the way these units co-operate and/or compete are identified as institutional arrangements. These provide a structure within which members can co-operate and also provide a mechanism that can effect a change in laws or property rights. Buchanan (1975, p.226) makes the distinction between the constitution that governs the whole policy process and

individual instances of policy making within this constitution. Williamson (1995, p.174) refers to institutional arrangements as the *institutions of governance* in his transaction cost analyses. Dixit (1996, p.18), following Buchanan, refers to the constitutional framework and policy acts. More recently, Williamson (2000) distinguishes between: 'informal institutions, customs, traditions, norms and religion'; formal rules of the game; governance or playing the game; and neo-classical economics and agency theory.

In the real world, the institutions of government operate under a number of constraints. These constraints include difficulties in reaching agreement on policies, problems in delivery, and problems of durability. These constraints create the transaction costs associated with the overall execution of government policy. Institutional analysis is about legislators choosing among available constitutional arrangements to *minimise* such transaction costs (Horn 1995, p.24). Competition between different organisational forms is assumed to be vigorous enough to ensure that only the most efficient survive. Williamson (2000, p.9) talks of feasible organisational alternatives all of which are flawed in some way. By flawed he means they exhibit signs of market failure. His approach is to rectify this asymmetric state of affairs by developing a feasibility criterion - 'an extant mode of organisation for which no superior feasible alternative can be described and implemented with expected net gains is presumed to be efficient'.

This approach is sometimes presented as though it will supersede conventional marginal analysis by its advocates. Failure to take account of the cost of monitoring agents and the imbalance of information will not lead to efficient outcomes. Governance is paramount. Yet Williamson himself simply ranks neo-classical models below governance issues (*op. cit.*, p.3). Getting the governance right he calls 2nd order economising (after getting the institutional environment right). Then getting the marginal conditions right is 3rd order economising. It seems to me that the issue is where do we place the point of control. One solution would be to include all costs of transactions within the model of the firm.

The new institutional economics eschews hypothetical ideals, says Williamson. These work off omniscience, benevolence, zero transaction costs, full credibility and the like. In this view, market failure could not be met by "omniscient, omnipotent, benevolent" governments administering efficacious remedies like a tax on a firm producing externalities (Dixit, *op. cit.*). Such Pigouvian simplicity is not acceptable without examining the feasibility of alternative organisational solutions. These solutions should be looked at first.

In discussing these issues, Buchanan (1975) observes that individual policy acts have to complement and fill gaps in the constitution, and to this extent the distinction between the constitutional contract and individual policy acts is often blurred since the policy act may provide a wide measure of interpretation of parts of the constitution. In almost no circumstances will advisors start with a clean sheet to correct some example of market failure. Given the ongoing nature of government policy making, economists should consider the economic problems of government not as agents seeking to maximise economic welfare but as arbitrators, seeking to work out compromises between conflicting claims. Dixit (*op. cit.*, p.71), emphasises that constitutions are

incomplete contracts, and the distinction between them and policy acts is one of degree, and not kind.

The making of government policy therefore needs to be examined in this kind of framework. This paper next discusses the role of transaction costs in government decision making and how the reduction of certain costs will contribute to certain political and organisational outcomes. This is followed by an examination of some published policy reviews to offer some verification of the hypotheses set out.

### **Transaction cost models of public administration**

The difficulties that political decision makers have in securing continued electoral support is the basis of the transaction cost model of public administration. The difficulties encountered in securing that support create the transaction costs that have to be overcome to achieve lasting and worthwhile policy change. Effective public administration requires that these transaction costs be *minimised* in determining and pursuing society's goals (Zeckhauser 1995). Legislators are regarded as self-seeking in their use of legislation to increase their net political support and lasting power. Their opportunities are limited by the transaction costs of achieving agreement on their proposals. These are the time and effort it takes to reach agreement on legislative refinements and any time and effort that affected private interests have to subsequently devote to participating in implementation and administration; political uncertainty that the legislation will last; uncertainty that the legislation will be administered as intended; and, uncertainty about the distribution of private benefits and costs (Horn 1995, p.13).

Dixit (*op. cit.*), in a similar approach, identifies costs involved in overcoming the asymmetric distribution of information between parties (signalling and screening costs, costs of monitoring and incentives, auditing costs and costs of misrepresentation), costs involved in managing agents (monitoring, incentives, and contractual obligations), costs of agents responding to multiple principals (co-ordination of policies, playing off one principal against another), and costs related to asset specificity (irreversible investments and lack of durability). Dixit makes it clear that transaction costs associated with ensuring durable agreements include the consequent loss of flexibility.

The elected/political appointees who are most likely to remain in power are those who are most successful in overcoming these transaction problems, such as those who are best able to reassure their supporters that the benefits of legislation will not be lost to administrators in the implementation, or undone by subsequent legislatures (Horn *op. cit.*, p.14).

Implementation of legislation will depend on the following agency relationships:

- the enacting coalition and its constituents (supporters) must rely on administrative agents to implement their proposals - it must delegate to get things done;
- these agents do not necessarily share the objectives of the enacting coalition and its constituents; and

- it is very difficult to monitor these agents and create a system of *ex post* rewards and sanctions that will ensure that they act to protect the interests represented at enactment.

These problems create agency costs - that is the costs incurred to induce administrators to implement faithfully what was intended in the legislature, and the losses legislators and constituents sustain by being unable to do so perfectly. They include the costs associated with selecting administrators and monitoring their compliance, the costs of using *ex post* corrective devices (rewards, sanctions, and legislative direction), and the cost of any residual non-compliance that produces a difference between the policy enacted and what is implemented (Horn *op. cit.*, p.19). There are a number of administrative mechanisms that legislators can draw on that *minimise* these costs: contracting out versus in-house delivery, tax-funded bureaux (departments), non-profit tax-financed regulatory agencies (e.g. in the US), and revenue-earning state-owned enterprises (as in the British system). Each has its advantages and disadvantages (Williamson *op. cit.*, p.179; Horn *op. cit.*, pp.9, 40, 170).

Private interests have a definite interest in implementation (Horn *op. cit.*, p.13).

"Legislators and their constituencies [Horn's term for private interests] are seen as engaged in a form of exchange. Legislators want electoral support and constituents want private benefits - or reduced private costs - in legislation. The amount of net electoral support legislators receive from promoting a piece of legislation depends on the flow of benefits and costs that private interests expect it to generate over time. The implementation features of the legislation bear on this calculus because private interests are sufficiently forward looking to anticipate how decisions on implementation will affect the flow of benefits and costs. That is why there are often heated disputes over decisions on matters like the scope of delegated authority, the form of organisation charged with implementation, and the procedures administrative agents must adopt. These factors affect "who" ultimately "gets what" out of the legislation".

Thus, the design of legislation reflects the interests of the different groups taking part in the political process and this reflects society's preferences for equity and efficiency considerations. In terms of durability, the flow of benefits to legislators is often much more immediate than the flow of benefits to constituents (Horn *op. cit.*, p.16). Constituents run the risk that the present or subsequent legislative coalitions might undermine the benefits of given legislation. This is a problem for legislators because forward-looking constituents will assess the durability of future legislative benefits and costs and reflect that assessment in the degree of electoral support they are willing to offer. Thus legislators cannot guarantee constituents durable benefits but they can make binding arrangements that might tie down future legislators to get that support. Constituents respond by seeking guarantees that these bindings will be in the implementation design, and that they will be consulted on the matters involved.

The distribution of costs and benefits also explains legislators choosing policies that confine the benefits to marginal voters (those whose votes count), and confine the costs to infra-marginal voters (those who are strongly committed to the governing

party); or choosing policies that provide benefits in concentrated form and impose costs in dispersed forms; choosing policies that will secure the co-operation of the bureaucracy; choosing policy instruments that minimise real costs over time when they fall on a small group; and choosing policy instruments that bring benefits within the current electoral cycle. Such behaviour is unlikely to be the random product of mistakes, ignorance or stupidity on the part of collective decision makers, but in many cases is likely to reflect systematic incentive structures that the community has built into political institutions such as 'one man-one vote' and regular elections (Trebilcock 1995, p.27).

### **Reducing transaction costs in Government**

This paper focuses on the transaction costs involved in the day-to-day policy process. The particular constraints that influence the final shape of policy and delivery have been identified. Overcoming these constraints lowers costs and raises efficiency. In political economy terms, solutions along these lines are more likely to represent some kind of consensual optima than a purely economic one (North 1990, p.15).

Economic advisors are more likely to take a technocratic view and offer an analysis of the economic effects of different organisational strategies to reach the same objective. Occasionally, they may have need to refer to the institutional parameters that might shape the outcome of the policy act proposed as noted by Buchanan. Dixit (*op. cit.*, pp.149-55) argues that this is inevitable and the advice process is not complete without it: "...the policy process should be thought of as an evolving, dynamic game; perhaps the economists' role should be viewed in a very similar manner".

Greater transparency reduces information asymmetries and reduces some transaction costs in the decision-making process (Dixit *op. cit.*, p.149). In terms of consultation with stakeholders, there has been a widespread recognition that greater public input could be made into the policy formation process. The Industry Commission in Australia (Industry Commission 1991)(now the Productivity Commission) and the National Centre for Food and Agricultural Policy in Washington, USA (NCFAP 1994), are organisations which conduct public reviews of policy issues.

In terms of the behaviour of delivery agents, some countries have introduced corporate management systems into the public arena (Aucoin 1990, Hood 1991.). These emphasise professional management in the public sector, the use of standards and measures of performance, and out-sourcing of services which were suitable for such treatment. These represent new 'institutional arrangements' for the conduct of government business and help reduce the transaction costs of implementing policy acts. Secondly, some governments have given consideration to the range of incentives which might reduce delivery costs and leakages. These include contracting arrangements and the use of alternative policy advisors.

Formal proposals for evaluation and review of policy programmes could assist in reducing the constraints associated with transaction costs. Regulatory impact statements (RISs) have been introduced in both Australia and New Zealand. A statement must be prepared for all new or amended regulations that directly or indirectly affect business, or restrict competition. In Australia, each statement should

be prepared early in the policy development process, and should set out (among other things), the options (regulatory and/or non-regulatory) that may constitute viable means of achieving the desired objective(s), an assessment of the impacts (cost and benefits) on consumers, business, government and the community of each option, and a consultation statement (Productivity Commission 1998). These directives are aimed at reducing the cost of mistakes, the cost of unacceptable outcomes, and the costs of poor implementation.

The new institutional economics has changed the thrust of policy analysis away from market failure to design and delivery issues. The broad aim is to devise rules and procedures that reduce transaction costs and improve outcomes. Clarification of the appropriate methodologies will enable policy analysts and advisors to governments to design better policy proposals.

### **Applying the Model**

The institutional approach to main stream agricultural policy issues is discussed in a recent study of the EU milk support policy (Williams 1997). This study particularly brings out the institutional constraints on changes in the EU milk policy and agency problems of implementation. This is followed by a discussion of the general place of marketing boards in Australia and New Zealand from an institutional point of view (Nixon 1993, Jarratt and Brown 1995).

Williams sets out to examine the implementation of the common liquid milk policy in the EU. He interprets his objective to be a review of the conduct of the policy in the Member countries. His base point is Article 39 of the Treaty Establishing the European Community. This leads him to reject a market failure approach and take an institutional approach (*op.cit.*, p.107) :

The performance criteria are here being used endogenously: the focus of attention is a judgement of how effective and efficient the policy and its delivery system is in fulfilling its *stated aims*. Many discussions of the CAP [especially those emanating from the UK] usually implicitly adopt a marginalist approach in which judgement is passed on the system in relation to what the writer *believes* would be the outcome of a free-market situation. Such discussions frequently dismiss *the aims* of the policy without discussion and never consider the policy delivery system. Nevertheless, the policy exists to fulfil the requirements of Article 39 of the Treaty, which remains in the original form and as such is part of "the economic constitution" of the 15 member states. Moreover, the narrower aims of the policy legislation, particularly as stated in the articles of 804/68, remain the law of the EU. The EU has an agreement with the contracting parties of the GATT: this may require fundamental modifications to the milk policy but not to the Treaty, as Article 39 is not currently on the agenda of the Inter-Governmental Conference for the revision of the Maastricht Treaty. Therefore the analysis of milk policy... considers the policy in relation to its aims and does not question the aims themselves. (*italics in original*)

The milk policy is definitely oriented to producer interests as Williams makes clear (*op. cit.*, p.20):

Around the central process of Community decision making through its principal constitutions there is considerable opportunity, particularly in agriculture and the dairy sector, for the activities of pressure groups and "industry experts" [usually the representatives and employees of powerful organisations in the industry]. Farmers' unions are represented in Brussels through the activities of COPA [Committee of Agricultural Producer's organisations in the EC] and co-operative marketing organisations are represented through COGECA [the general Committee for Agricultural Co-operatives in the EC]. The dairy trade also has a European organisation, [EDA - formerly ASSILEC] the European Dairy Association, with representatives in Brussels. Each of these bodies is able to obtain representation on the Commission's Milk Advisory Committee, and through this channel farmers and industry marketing organisations can exercise influence on proposals to be made to the Council as well as on the implementation of policy by the Commission.

The problems met in formulating the common policy for milk are referred to as follows (*op. cit.*, p.31):

It took the original Six members of the Community eleven years to achieve a common policy for milk and the other major commodities of cereals and beef. In the milk sector each member state had differing levels of protection for milk producers and different methods of achieving it. In Germany and the Netherlands the liquid milk market and the manufacturing or industrial milk market were separated with elaborate methods of pooling prices between the two to obtain the producer price. In order to establish free trade within their borders the Six had to harmonise support prices and intervention measures, eliminating border taxes and controls between themselves in transitional steps, and establish a common level of tariffs on imports of dairy products from third countries in matching steps. Export refunds had to be established and harmonised *pari passu*. The transitional system introduced a mechanism with a set of intra-Community levies on trade to be gradually eliminated in a series of steps as external tariffs and internal intervention measures were harmonised. Agreement in this process was achieved by the gradual alignment of the level of protection afforded by measures in the highest-price country.

There is a three tier system of implementation :

.....at the first level are the Community institutions that are involved in policy making and objective setting, as well as in the implementation process. At the second level are the institutions of national governments [15 of them] each having some flexibility, albeit limited, in operating the system. At the third level are the marketing agencies who are responsible for their own strategies in a competitive market, and are affected by the normal factors in a market Structure-Conduct-Performance relation of investment, economies of scale, product differentiation, advertising and brand loyalty, research and development, and consumer demand for dairy products.

The different attitudes of the bureaucracies in member states to quotas have given rise to much variation in milk prices (*op. cit.*, pp.77, 109):



...the amount of variation in the system throughout the Community is very considerable. ....At one extreme, the Republic of Ireland has generally had the lowest price with prices sometimes below 90 per cent of the Target Price i.e. below the intervention milk equivalent price. At the other, Italian producers have had prices estimated to be as high as 130 per cent of the Target Price...Ranges of this magnitude and variability could not reasonably have been said to have been the intention of the original designers of the policy who sought to eliminate variations that might occur through any arrangements that would protect local liquid milk prices. Explanations of price differences are complex and may relate to many structural differences between countries, the size of the processing/marketing organisations and economies of size, product differentiation, brand loyalty, and the management and ownership of marketing organisations.

Williams finds that the *average* target prices achieved from 1989 to 1995 over the 8 member countries were very near to that aimed for but that there was marked variation between countries. He notes average farm incomes have risen from 1978/79 to 1990/91 while the target price measured in ECUs moved very little. He attributes the positive structural changes which have taken place to the quota system and assistance for 'outgoers'. Most member states have succeeded in keeping to within one per cent of their national reference quantities in most years.

This study is grounded in institutional economics. The institutional environment is kept separate from the day-to-day policy enactments. The beneficiaries of the policy are heavily involved in the policy process. There are complicated agency relationships between the Union and the States and between the States and the market agencies. It would appear that the transaction costs of the policy mix, especially of monitoring the agents at two levels, are very high. The author does not address whether alternative organisational structures could be more efficient. [He appears to think it would be a waste of time]. He concludes that analysts should always start with the aims and objectives of given policies and recognise that when they have been absorbed into a hard-fought-for constitutional agreement [the Treaty] they will be very hard to change indeed.

### **Marketing Boards and Organisation Theory**

Marketing boards are creatures of statute and hence are answerable to the legislature. On the other hand, they usually have some formal requirement to consult the members of the industry they represent and provide for elections for directors (Jarratt and Brown 1995, p.420). They used to be the most common form of market intervention in both Australia and New Zealand. Institutionalists would argue that the legislatures at the time would have had good reasons to choose this particular form of organisation.

A marketing board is a form of regulatory agency which is charged with certain market intervention powers and other functions such as promotion and research. They are not tax-funded as a rule except in emergencies. They usually have elected directors from the group of producers involved in the product to be regulated. In New Zealand, they were, at times, funded generously through the Reserve Bank. Boards are an organisational form in which decision making is delegated from Government to

directors and their paid employees. Instead of being directly answerable to the legislature, marketing boards were made answerable to the interested producer group.

In this view, boards are specialist organisations better conducted outside central government. Their task is to collect and act on specific market information. It would be more costly for a central administrative unit. Information gathering costs are lowered by specialisation. By the same token, this organisational form increases the participation of the interest group concerned. In a measure, the interest group agrees to this particular form of organisation because they perceive that benefits for them are more likely.

In terms of agency theory, monitoring and supervision of the organisation is passed from the legislature to the participants subject to various statutory provisions like audit. There is the implicit assumption that the directors are best made answerable to an electorate of producers and transaction costs would be lower. The main reason for this is that the producers are likely to be nearly as expert in market expertise as the agency, and can make more profound judgements about their performance. As a corollary, the monitoring link with the legislature is weaker, and the informational imbalance is much greater. The latter might be quite a problem when statutory reform is envisaged by the legislature. Nevertheless, such a structure was the chosen form when the key design decisions were made. In recent years, at least in New Zealand, attempts have been made to strengthen the monitoring and evaluation powers in the various Acts with formal five-yearly external reviews and the like.

There is thus a good case for believing that transaction costs are minimised in this form of organisation. A Board's main activities are collecting information on market intelligence, monitoring industry participants, research, forecasting production and export levels, quality control, and policy work. A Board with trading responsibilities will also have a network of procurement agents and sales agents around the world with strong informational collecting requirements.

For example, the NZ Wheat Board was established in 1965, in a process of consolidation of previous market interventions with powers, not unlike those of EU milk policy, to balance production and imports of wheat, determine farmers' prices, determine milling and manufacturing margins, and to recommend the price of bread to Government. It therefore exhibits the kind of problems that agencies encounter when tied to Government policy.

The Board was set up by Act of Parliament to rationalise and co-ordinate wheat production and imports and regulate the prices and quantity of flour. The Board was required:

- i. to control the acquisition and marketing of wheat and flour generally;
- ii. to encourage wheat growing and the use of wheat grown, having regard to the best use of land available, the cost of imported wheat, conservation of overseas funds, and other relevant considerations;
- iii. to ensure that adequate supplies of wheat and flour were available; and
- iv. to promote and organise the orderly development and greater efficiency of the wheat and flour milling industries.

There was a considerable history of intervention before 1965. A wheat purchase board had been created in 1933 with power to purchase all wheat and fix prices to the growers and millers, but not on imports. In 1936, a Wheat Committee was formed to take over sole responsibility for the buying and selling of all wheat, including imports. Price controls were introduced in 1939 for the wheat, flour and bread sectors which placed marketing under direct government control. In 1962, a Commission of Enquiry was instituted and it recommended the consolidation of the existing arrangements, including price control, in a new enabling Act. A commission of enquiry approach suggests that interested pressure groups were fully consulted in the public process of consultation, though the sources are silent on the design aspects of the legislation itself. In practice, in the NZ parliamentary system, legislation is framed by the bureaucrats and interested parties have only limited access, but access nevertheless, at the Select Committee stage of a Bill.

Two literature sources do not discuss alternative instruments [the heart of the institutional argument] that might have been available at the design stage (Sandrey and Reynolds 1990, Nixon 1993). Documentation of alternative instruments discussed at the time would be hidden in departmental archives. It is significant that both sources mostly document needed changes to the legislation after the legislation was no longer fulfilling its aims - a national welfare point of view. They do not analyse whether the original aims of the legislation were met in the intervening period - an institutional view.

The NZ Wheat Board administered the legislation from 1965 to 1987 and from 1980 had to meet an increasing number of regulatory changes introduced by the Government. The documents indicate that the Board, as the Government's agent, was faithful to the objectives laid down for them but that external events overtook them (Sandrey and Reynolds *op.cit.*, p.127):

The key decision concerned the purchase price of wheat from farmers, a price set to recoup all Wheat Board costs, as this subsequently triggered other decisions such as the consumer price of flour. Each flour miller was paid the calculated cost of processing wheat into flour. These costs were independently calculated for each mill, leaving millers with limited commercial interest in the price of wheat. Indeed the only Board members who had a strong commercial interest in the price paid for wheat were the farmers. The Board maintained a pricing policy designed to encourage domestic production of wheat and, therefore, self-sufficiency.

The sources are not precise on the course of producer prices, import replacement prices and prices of alternative enterprise products during the Board's administration. It appears that Australian wheat could be landed in NZ more cheaply than equivalent NZ grown wheat in most years and that pastoral products [especially lamb production] were competing for the same land. The Board was thus forced into large imports of Australian wheat [up to 100,000 tonnes in some years] to meet its adequacy commitments. Sandrey and Reynolds (*op. cit.*, p.132) state that in 1974 and 1975, and in 1981, 1982 and 1984, NZ producers were receiving *less* than the equivalent Australian price though not in other years.

In the event, the Government removed price control on bread in 1980, introduced a producer price based on a three year average of landed Australian prices in 1981, abolished flour, bran and pollard price control in 1984, and eventually required that the Board cease trading in 1987.

The original aims were focused on producer welfare with the market system being driven by producer price negotiations with Government. One commentator stated (Ali 1993): "It was very much a supply driven system, emanating from the growers, whereas consumers were largely tamed by regulations". The legislation was enacted in a period when intervention in markets was highly fashionable among politicians and bureaucrats. The interesting feature of the legislation is that a once-removed marketing agency was chosen to administer the policy, which, in other areas, was carried out in administrative departments. The Board consisted of representatives from Government [including the chairman], and industry representatives from producers, millers and bakers. The Board was handicapped by its charter with its emphasis on encouraging domestic wheat growing which the Board interpreted as promoting self-sufficiency (Nixon, *op. cit.*, p.23). Finally, the Board had to negotiate a producer price with the farmers' interests that still required approval by Ministers. The conclusion must therefore be reached that it was the structure that was at fault and not the agency administering the policy. This is, of course, contrary to the views given in the documents and the popular view of events in the period concerned. But it does confirm the Williams view that policy delivery must be examined in its context, and not judged out of context.

An institutional view of these developments is that the legislature (with the help of its advisors) was seeking to loosen the wartime model of marketing a key commodity. They chose a semi-independent marketing board as their desired organisational form. There is no record that they were contemplating free markets at the time. Yet within a period of 15 years they were contemplating the removal of price controls and within 22 years had moved to a free market philosophy. This was still 7 years before the 1984 Labour Government re-organisation, which was based on a thorough-going application of agency theory and transaction costs (Boston *et al* 1996, p.21). Institutional change appeared to follow economic necessity. Without regulation of prices and margins, there has been a reduction in the farmers' interest and an increase in the power of the millers and bakers.

## **Conclusions**

Institutional analysis lays great stress on organisational forms and asks whether improvements in welfare can be sought by better forms of governance? The analysis derives from a transaction cost perspective of the exchanges taking place. Organisational change might reduce transaction costs as originally derived by Coase. While some proponents of institutional analysis tend to disregard the marginal conditions of the neo-classical model, it appears there is room for both in well-defined contexts.

The examination of the EU milk policy reveals the rigidity that the Treaty of Rome imposes on changes in policy. The distinctions between constitutions and policy acts made by North (1990), Buchanan (1975), and Williamson (1995, 2000) are fully

confirmed by this analysis. The CAP is characterised by very high transaction and implementation costs

Marketing boards can also be interpreted as organisational variants of government agencies which are established by statute. They are characterised by delegation of powers to elected boards of directors to meet some desirable market intervention. This tends to make them less responsible to the legislatures that created them and more responsible to the private interests concerned with the product involved. Theory suggests that the private interests are in a better position to monitor a board's activities than the legislature and its agents. The legislature also tends to defer to the wishes of producers when reform is being discussed (Jarratt and Brown, *op. cit.*, pp.420-423).

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