(Chong, 1991), East Asian peasant uprisings (Popkin, 1979), the origins of the Mafia (Gambetta, 1993), the evolution of the firm (Miller, 1992), the military draft (Levi, 1997), ethnic conflict (Hardin, 1995), and the management of common pool resources (Ostrom, 1990).

Olson’s book and the work it has inspired cannot, however, explain everything. One of its limitations has already been discussed; Olson assumes that actors are self-interested. Whilst this assumption may sometimes be of value, it cannot be used to explain the behaviour of those who join or contribute to groups because they simply believe that it is the right thing to do. I will conclude by briefly pointing to a second limitation. The Logic of Collective Action tells us something about the ways and circumstances in which groups can overcome the collective action problem posed by free-riding, yet Olson’s book does not (and does not claim to) provide a comprehensive theory of collective action. It cannot tell us about how individuals acquire interests which lead them to identify with a particular group; how the members of a group agree on particular policy platforms; how and when particular forms of collective action induce changes in government policy; and how and why groups sometimes collapse. There is no reason why rational choice theorists cannot address these topics. But it would be a mistake to think that only rational choice theorists can do so. If anyone were to attempt to formulate a comprehensive theory of collective action, they would be advised to draw not only on Olson but on work conducted by, for example, social psychologists showing how our identification with and membership of groups is an essential part of our personal identity (Tajfel and Turner, 1986; Haslam, 2000) and on political scientists’ findings that ‘insider’ (Grant, 2000) groups operating within sectional policy communities (Marsh and Rhodes, 1992) are more likely to influence policy.

Chapter 6

William Niskanen and Bureaucracy

Overview: Bureaucrat and bureaucratic are routinely used as terms of abuse. In novels bureaucrats are portrayed as faceless tyrants (Kafka’s The Trial), incompetent wastrels (Dickens’ Little Dorrit) or petty time-servers (Balzac’s Bureaucracy). In Bureaucracy and Representative Government, William Niskanen argues that public-sector bureaucracies ‘supply an output up to twice that of a competitive industry faced by the same demand and cost conditions’ because bureaucrats maximize the size of their budgets (Niskanen, 1971: 64). The public sector is inefficient and it is inefficient because public-sector organizations are bloated. Niskanen’s argument has proven to be both academically and politically important. Academically, Bureaucracy and Representative Government remains ‘the most cited and influential theory of bureaucracy to emerge within public choice’ theory (Moe, 1996: 458). Few, if any, rational choice theorists, Niskanen included, now argue that bureaucrats are budget-maximizers. But Bureaucracy and Representative Government has nevertheless set the research agenda for work in this area. Politically, Niskanen’s work has encouraged efforts to ‘roll back the frontiers of the state’ (Thatcher, 1993: 744–5) through privatization, contracting-out and the creation of internal markets.

In the first part of this chapter I briefly document the growth of the state in the postwar years. Having identified some of its intellectual precursors, Niskanen’s argument is introduced through the behavioural assumption that bureaucrats derive utility from increases in their budgets, and the equilibrium argument that they can extract inefficiently large budgets from their political sponsors. Subsequent sections review more recent work. The behavioural assumption that bureaucrats maximize the size of their budget is contrasted with claims that bureaucrats maximize the size of their discretionary budgets or, alternatively, that they ‘bureaucratize’. The equilibrium argument that bureaucrats can extract inefficiently large budgets is contrasted with the claim that politicians actually dominate bureaucrat.

Setting the stage: the growth of the state

As Table 6.1 indicates, between the outbreak of the First World War and the early 1980s, the state more than doubled in size in every one of the
As might be expected, rational choice theorists offer a very different set of explanations; they present the growth of the state as resulting from political failures, and two arguments have proven particularly influential. The first, which we will concentrate upon here, is that the growth of the state can be attributed to the ability of bureaucrats to hijack the political process and push public expenditure above those levels favoured by the median voter. The second, which we will examine in the following chapter under the broad heading of rent-seeking, is that the state has grown because politicians have found it in their electoral self-interest to sell policy favours including expenditure programmes and increased regulation to interest-groups.

The precursors of bureaucratic theory

In the introduction to *Bureaucracy and Representative Government*, Niskanen (1971: 7) identifies three ‘venturesome economists’ whose work he regards as having provided both the inspiration for and the foundations of his own theory. These are Gordon Tullock, some of whose work on rent-seeking we will examine presently, Anthony Downs, whose work on party competition we discussed in Chapter 2, and Ludwig von Mises.

Along with Leon Walras and Stanley Jevons, Ludwig von Mises (1881–1973) is one of the economists usually credited with having launched the ‘marginal’ revolution in economics paving the way for the transition from classical to neo-classical economics. In his later years, Von Mises, who was a fierce proponent of the free market, participated in the ‘calculation’ debate about the economic feasibility of socialism (see Lavoie, 1985), and it was in this context that he wrote *Bureaucracy*. Like his contemporary Friedrich von Hayek, whose *Road to Serfdom* is now more frequently cited, Von Mises argues that the growth of the state and thereby of state bureaucracy undermines individual freedom. Never one to knowingly underestimate his case he goes so far as to suggest that ‘the struggle against the encroachments of bureaucracy is essentially a revolt against totalitarian dictatorship’ (Von Mises, 1944: 18). Yet Von Mises also develops a more nuanced economic argument about the nature of bureaucratic decision-making upon which Niskanen draws directly.

Von Mises (1944: 47) defines as bureaucratic any organization which “specialises in the supply of those services the value of which cannot be exchanged for money at a per-unit rate”. Private-sector firms
Box 6.1 Market failure

The first fundamental theorem of welfare economics holds that perfect markets generate Pareto-optimal results (Stiglitz, 1996: 27–43). Market failures arise when markets fail to efficiently provide or allocate goods and services, and economists have identified a number of different sources of market failure (see Stevens, 1993: 55–74 for a more detailed discussion):

1 Public goods. Individuals will not find it in their interest to contribute to the provision of non-excludable and non-rival public goods or to limit their consumption of non-excludable but rival common pool goods (5.1).
2 Externallities. Self-interested individuals will not find it in their interest to take account of the positive or negative consequences of their actions on others. As a result, competitive markets over-supply those goods which generate negative externalities harming others and under-supply those goods which generate positive externalities benefiting others. As an example of a negative externality, consider the smoke emitted by a factory which damages the sheets left out to dry in a neighbouring garden. Unless they are liable for compensation, the owner of the factory has no incentive to take account of that damage. As an example of a positive externality, consider the benefits a passer-by might derive from looking at the flowers in someone else’s front garden.
3 Monopoly and imperfect competition. Monopolists find it in their interest to raise price and restrict supply so reducing consumer welfare.

operate within competitive or at least ‘contestable’ (Baumol et al., 1982) markets and sell units of their output at a specified price. Public-sector bureaucracies operate outside of the market and provide particular goods and services in exchange for budgets granted by their political patrons. Such organizations, Von Mises suggests, find themselves effectively exempted from the demands of economic calculation and are, as a result, usually inefficient. Bureaucratic management is ‘wasteful, inefficient and slow’ because bureaucrats only care about taking those decisions which are consistent with established rules and precedents (Mises, 1944: 48). This was an important argument because it tied already well-established claims about the inefficiency of public-sector bureaucracies to the underlying economic position of those bureaucracies rather than the personal failings of individual bureaucrats.

4 Inadequate information. In those situations where individuals cannot easily judge the quality of the service or veracity of the advice they are being offered, producers can exploit their customers. Consider the position of, for example, a patient who is told by their dentist that they need a filling. How can they know whether the dentist is saying this because they really do need a filling or because they can make an additional profit by charging for it?
5 High transaction costs. Markets fail when the costs of deciding, planning, arranging, negotiating and enforcing exchanges are greater than the benefits to be derived from that exchange.
6 Inequality. Some economists would argue that markets fail if and when they generate severe inequalities in income.
7 Demand and supply. Keynesian economists argue that markets fail because there is no mechanism to ensure equilibrium between total demand and supply. In such cases, market allocation leads to periodic recession and unemployment.

Welfare economists maintain that market failure justifies government intervention to, for example, break-up or nationalize monopolies, provide public goods or correct for externalities. Rational choice theorists argue that welfare economists have shown how and why the market might sometimes fail but have simply asserted rather than demonstrated the ability and willingness of the state to correct those failures. In comparing the virtues of the state with those of the market, welfare economists make a misleading comparison between the reality of imperfect markets and the fiction of a perfect state. Voting cycles, budget-maximization and rent-seeking also lead to government failure.

Gordon Tullock, who once worked as a senior official in the American State Department, published The Politics of Bureaucracy in 1965. He argues that the crucial feature of bureaucracies is not simply that they are hierarchies, but ‘pyramidal’ hierarchies with fewer people at the top than in the lower ranks (Tullock, 1966: 33). The relationship between junior and senior bureaucrats is one of principal and agent (Box 6.2). Bureaucracies work efficiently to the extent that bureaucrats in junior positions pass on the ‘right’ information to their superiors. Once this information has been collated, those at the top of the pyramid are then meant to reach a decision which is communicated back down the pyramid before being implemented by those at the bottom.

The first problem with this account, Tullock argues, is that the pressures on those at the top of the pyramid are such that very little useful information can actually be passed on to them before a decision is
Box 6.2 Principals and agents

A principal-agent relationship arises when one person, the principal, contracts with another person, the agent, to undertake tasks on their behalf. P-A relationships are a pervasive feature of life. Employers hire employees; homeowners sign contracts with estate agents to market their house; and patients pay doctors to diagnose and treat their illnesses. Within the political arena, voters select representatives to represent their interests; in parliamentary systems representatives then select governments; and governments must then rely upon bureaucrats to implement their policies. For two reasons, economists generally expect P-A relationships to generate P-A problems. First, principals usually have incomplete information; they cannot know, or can only find out at a great cost, whether agents are acting in the way that they would want them to act. Second, agents will not necessarily act in their principal’s interests unless induced to do so; agents have conflicting interests whether in ‘shirking’ or in pursuing their own policy preferences.

P-A problems can be managed in a number of ways. (1) Principals can devise contracts that link an agent’s payment to their performance. But if this performance depends upon the agent’s efforts and some random variable then risk-averse agents may well require higher overall payments to compensate for the resulting uncertainty. (2) Agents can sometimes be deterred from shirking by principal’s threats to terminate their relationship if performance falls below some level. (3) P-A problems will be most acute in short-term relationships. By offering agents the prospects of entering into long-term relationships, agents can be made. Precisely because there are so few people at the top of the pyramid, only a tiny fraction of what each junior bureaucrat knows can possibly be known by those senior bureaucrats making decisions. The second problem with this account is that it ignores the potentially conflicting interests those in subordinate positions have. Junior bureaucrats have an interest in impressing their superiors and those superiors have an interest in impressing their superiors and so on. Most bureaucrats will therefore filter any information they receive and only pass on that part of it which they believe shows them in a good light or which their superiors want to hear. Rather than information being passed up the pyramid, this means that ‘factual information tends to flow from the top down instead’ (Tullock, 1965: 70). Each bureaucrat will have more interest in finding out what their superiors think about particular issues than they will in finding out about what is happening in the outside world.

given an incentive to acquire a reputation for being trustworthy (Radner, 1981) (Box 5.4). (4) Through the design of careful selection procedures principals may succeed in hiring agents who share and so naturally pursue their interests. It is, however, unlikely that principals will be able to (or want to) eliminate P-A problems. This is because it may well cost the principal more to eliminate the P-A problem than they gain from doing so. In such cases the existence of some agency costs may well be economically efficient.

Principal-agent analysis has recently been applied to the study of bureaucracy in a number of different ways. Jonathan Bendor and Adam Meirovitz (2004) show that the existence of a P-A problem between bureaucrats and legislatures does not hinge upon the assumption that bureaucrats are risk-adverse. Michael Ting (2003) shows how bureaucratic ‘redundancy’ – the allocation of the same functional responsibilities to several bureaucracies – can help a principal achieve their goals when bureaucratic agents have conflicting preferences but can, in other circumstances, generate debilitating collective action problems. Nolan McCarty (2004) suggests that the separation of powers in the American political system can exacerbate the P-A problem in so far as it sometimes gives the Executive an incentive to appoint senior bureaucrats with very different policy preferences from the median Congressman and Congress an incentive to then starve that bureaucracy of funding. Finally, John Huber and Nolan McCarty (2004) suggest that low bureaucratic ‘capacity’ in developing countries can lower the incentive bureaucrats have to comply with legislation so reducing the incentive politicians have to delegate tasks to them.

Problems of this sort mean that bureaucracies are generally extremely inefficient. They usually ‘accomplish something, but [they] will not perform the task for which they are designed’ (Tullock, 1965: 97). The solution, Tullock argues, is to rely less upon the state and more upon the market and private firms. The market is, as he acknowledges, an imperfect mechanism for allocating resources. Individuals will make poor decisions about which products to make and this will result in resources being wasted. But the market does not require information to be centralized before decisions are made and gives participants an incentive to take those decisions they believe are right rather than those decisions they believe their superiors will approve of.

Anthony Downs’ (1967) Inside Bureaucracy also examines the flow of information within and political control over public bureaucracies. In Downs’ work, this results in the formulation of a series of ‘laws’ such as the ‘law of diminishing control’ and the ‘law of counter-control’. The
most interesting aspect of Downs’ work, and the one which Niskanen most obviously draws upon, is however his discussion of bureaucratic behaviour. Bureaucrats, Downs (1967: 2) argues, are often self-interested and are always rational utility-maximizers. They do not, however, always behave in the same way. There are instead five behavioural types (Downs, 1967: 88–111):

1 ‘Climbers’ who maximize their power, income and prestige by securing promotions or acquiring additional responsibilities in their existing jobs.
2 ‘Conservers’ who maximize their security by defending their existing responsibilities but minimise their effort by avoiding additional ones.
3 ‘Zealots’ who develop a consummate commitment to the policy area they work in and promote its expansion.
4 ‘Advocates’ who defend the interests of their department or agency in the belief that they can serve their clients’ interests by doing so.
5 ‘Statesmen’ who have a broader commitment to the public interest.

In terms of connecting Downs’ argument to that of Niskanen’s, two points are worth making. The first and most obvious one is that Downs’ ‘climbers’ and Niskanen’s ‘budget-maximizers’ appear to be cut from the same cloth. The second draws us back to the discussion of An Economic Theory of Democracy. Downs’s argument about the behaviour of political parties was, it will be recalled, inspired by Joseph Schumpeter’s insight that public policy is the by-product of, rather than the motive for, party competition. In the case of two of his five behavioural types, Climbers and Conservers, Downs argues that the implementation of public policy is, in the same way, a by-product of the individual pursuit of self-interest. In Bureaucracy and Representative Government Niskanen adopts the same basic approach. Public policies are provided not because it is in the public interest that they are provided but because it is in bureaucract’s self-interest to provide them.

The budget-maximizing bureaucrat

William Niskanen (1933– ) completed his doctorate in economics at the University of Chicago. Having worked for a time at the Rand Corporation, he joined the staff of the incoming Secretary of State for Defence, Robert McNamara, following John F. Kennedy’s election in 1960. Having subsequently chaired President Reagan’s Council of Economic Advisors, he was appointed as Chairman of another think-tank, the Cato Institute, in 1985. In the preface to Bureaucracy and Representative Government, Niskanen writes that whilst working at the Rand Corporation he shared the general assumption of his colleagues that bureaucratic inefficiency could be ameliorated if not eliminated through the introduction of improved information systems. It was his time working at the Department of Defence which convinced him that this was not so; that ‘there is nothing inherent in the nature of bureau’s and our political institutions that leads public officials to know, seek out, or act in the public interest’ (Niskanen, 1971: vi).

Niskanen’s argument in Bureaucracy and Representative Government can be broken into two parts: the behavioural assumption and the equilibrium argument. The behavioural assumption is that public sector bureaucrats find it in their interests to try and maximize the size of their budget. The equilibrium argument is that they usually succeed in doing so.

The behavioural assumption

Within neo-classical economic theory it is assumed that entrepreneurs are profit-maximizers. Bureaucrats cannot, by definition, be profit-maximizers because Niskanen (1971: 15), drawing heavily upon Von Mises, defines bureaucracies as non-profit-making organizations whose revenues derive from periodic grants. So what is it that self-interested bureaucrats maximize? Niskanen follows Downs in assuming that bureaucrats value a range of goods including power, monetary income, prestige and security. Yet he cuts through the complexities of Downs’ argument by suggesting that nearly all of these variables are positively related to the size of the bureaucrat’s budget:

Among the several variables that may enter the bureaucrat’s utility function are the following: salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes and ease of managing the bureau. All of these variables except the last two, I contend, are a positive monotonic function of the total budget of the bureau during the bureaucrat’s tenure in office. (Niskanen, 1971: 38; emphasis in original)

The fact that two of the factors Niskanen mentions, the ease of making changes and the ease of managing the bureaucracy, are not related to
the size of budget may seem to fatally compromise his argument. For if some bureaucrats – and at this point, Downs’ Conservers spring to mind – value ease of management over power, patronage and higher salaries, they will not budget-maximize. Yet Niskanen’s argument is, at this point, actually quite a subtle one. For whilst accepting that bureaucracies with larger budgets are harder to manage and reform, he argues that budget increments can, in the short-term at least, nevertheless make a bureaucrat’s life easier. This, he suggests, ‘creates a treadmill phenomenon, inducing bureaucrats to strive for increased budgets until they can turn over the management burdens of a stable higher budget to a new bureaucrat’ (Niskanen, 1971: 38).

Niskanen’s argument about budget-maximizing ought to be seen in the context of an existing debate within economics. In the 1950s and 1960s a number of economists began to argue that the rise of the giant corporation had rendered the assumption of profit-maximization redundant. Salaried managers with no stake in the ownership of a firm had, it was argued, no real incentive to maximize their employer’s profits. But what did managers maximize if not profits? The alternatives canvassed at this time included the number of staff, autonomy from shareholders, and perks such as overseas conferences and plush offices. But as William Baumol (1959) first observed, many of these variables are positively related to the size of the corporation. For this reason, managers will, he argued, be growth-maximizers. In response, critics argued that whatever it is that managers may want to do, the discipline of market competition and the need to retain the confidence of shareholders actually gives managers no alternative but to maximize profits. But, as Niskanen grasped, whether or not this is true, the same discipline does not exist within the public sector where there is no requirement to return a profit and no guarantee that those who succeed in cutting costs will actually be rewarded:

The rationality of budget maximization by bureaucrats may best be illustrated by considering the consequences of contrary behaviour. Consider the probable consequences for a subordinate manager who proves without question that the same output could be produced at, say, one-half of the present expenditures. In a profit-seeking firm this manager would probably receive a bonus, a promotion, and an opportunity to find another such economy . . . in a bureau, at best, this manager might receive a citation and a savings bond, and the suspicion of his new colleagues. Those bureaucrats who doubt this proposition and who have good private employment alternatives should test it . . . once. (Niskanen, 1971: 38)

The equilibrium argument
At some point in the budgetary cycle, senior bureaucrats submit budget requests to their political patrons in government. Bureaucrats will want to acquire as large a budget as possible. Politicians will have some interest in resisting their demands. Niskanen (1971: 64) argues that the resulting negotiations conclude with public bureaucracies supplying ‘an output up to twice that of a competitive industry faced by the same demand and cost conditions’. So what advantage do bureaucrats have over politicians which allows them to inflate budgets in this way? Niskanen offers two answers to this question. The first is that bureaucrats have more information about the costs of supplying particular levels of output. The second is that they can make ‘take-it-or-leave-it’ offers to their political patrons. We will consider each of these in turn.

Private-sector firms sell particular units of output – be it pints of milk or ocean liners – at a given price. Public-sector bureaucracies instead offer to provide a total output – a certain number of hospital beds, army divisions or school meals – in return for an agreed budget. In bargaining about the level of budget and output, Niskanen credits politicians with the possession of four powers or capacities. The first is that of selecting the overall level of output to be produced. This means that bureaucrats cannot budget-maximize by simply selecting a level of output requiring an enormous budget. The second is ensuring that bureaucrats fulfil any promises they make about the level of output they will deliver in return for an agreed budget. This means that bureaucrats cannot budget-maximize by promising to, for example, provide one hundred hospital beds in return for a budget of one million pounds even if they know that they cannot achieve this. The third is ensuring that the total benefits individuals derive from consuming whatever output it is that the bureaucracy provides are equal to or greater than the total costs of providing it. This means that bureaucrats cannot budget-maximize by setting a budget which is so high that the costs of the resulting output exceed its benefits. The fourth is that of ensuring that the marginal benefits of any output are not negative. I will say more about this final condition presently.

The existence of these capacities implies that politicians have access to detailed information about bureaucratic output and costs. Politicians need to know a great deal in order to know when the total costs of providing a particular level of output will exceed the total benefits individuals derive from consuming it. Yet Niskanen critically assumes that only bureaucrats know what the minimum costs of
producing particular levels of output are. When a senior bureaucrat tells a politician that it will take a certain level of budget to provide a certain level of output, the politician will not know whether it would be possible to provide that level of output at a lower cost. Because bureaucrats know that politicians do not know what the minimum costs of producing various levels of output are, they can budget-maximize.

Niskanen’s second argument is that bureaucrats can inflate their budgets by making ‘take-it-or-leave-it’ offers. In Figure 6.1 the quantity of some good which is being produced is shown on the horizontal axis and price and cost on the vertical axis. Notice that the marginal benefit consumers derive from the consumption of a good (from which can be derived the demand curve) decline as output increases and that marginal costs (from which can be derived the supply curve) increase as production costs rise. Economists generally argue that profit-maximizing firms will produce additional units of output up to that point at which the marginal benefits of doing so are equal to marginal costs. In Figure 6.1 such a firm will therefore produce output Q at price P. At this equilibrium total consumer ‘surplus’—which measures the difference between what some consumers have paid for the good and the amount they would have been willing to pay—is shown by the shaded area A–B–C.

How much will a budget-maximizing bureaucracy produce? We will follow Niskanen in initially assuming that politicians accurately represent individuals’ demand for particular goods and services and that the marginal benefit schedule for a bureaucratically-produced good is therefore the same as it is for a privately-produced one. Assume now that bureaucrats can make take-it-or-leave-it offers; in other words that they can offer to produce a certain level of output in return for a certain budget and credibly threaten not to produce anything if this request is rejected. In Figure 6.2 assume that bureaucrats demand a total budget of 0–C–D–Q, in return for a promise to produce output Q. This budget corresponds to the total costs of producing output Q, that is a total output of the area 0–C–D–Q. This budget and output combination is clearly sub-optimal because the marginal costs of producing output Q–Q are greater than the marginal benefits. In this particular case the resulting ‘waste’ B–D–E is exactly equal to the surplus A–B–C. This is in fact the equilibrium output because if bureaucrats were to ask for a larger budget total waste would be greater than the total surplus.
Faced with a take-it-or-leave-it offer, the vote-maximizing politician would have good reason to reject such an offer because at this point they would prefer zero output with zero benefits and costs to an output whose costs were greater than its benefits. If, on the other hand, the bureaucrat were to ask for a budget of less than this amount, consumer surplus would be greater than total waste and the politician would accept the budget offer. Yet bureaucrats will not make such a budget offer precisely because they could ask for and receive more.

Figure 6.2 shows the standard situation of what Niskanen calls a ‘budget-constrained’ bureau. As a footnote to this argument it is worth noting that Niskanen also discusses the position of what he calls a ‘demand-constrained’ bureau. In Figure 6.3 the marginal benefits and benefits of producing this good are lower. If this bureau were to produce that level of output at which total surplus equalled total waste it would produce $Q_2$. But notice that the marginal benefits of some units of this output – those between $Q_1$ and $Q_2$ – would then actually be negative. In his information-based argument, Niskanen suggests that politicians will know enough about the costs and benefits of bureaucratic output to prevent this from happening. Politicians will refuse any budget demand some of whose output generates negative marginal benefits. The equilibrium output of this bureau will therefore be $Q_1$ and its total budget $0-A-B-Q_1$. We will return to some of the implications of this argument presently.

What are we to make of Niskanen’s arguments? The idea that bureaucrats possess more information than their political patrons is a venerable one. It can be found not only in Tullock and Downs’ economic theories but in, for example, Max Weber’s sociological analysis (see Beatham, 1987). The claim that bureaucrats can make ‘take-it-or-leave-it’ offers appears, on the other hand, entirely fanciful. Niskanen defends it by suggesting that these two arguments have the same consequences; it makes no difference whether it is assumed that bureaucrats can make take-it-or-leave-it offers or whether only bureaucrats know what the minimum costs of producing certain levels of output are. By implication, the assumption that they can make take-it-or-leave-it offers can be regarded as little more than a presentational device and defended on the instrumentalist grounds that theories ought to be judged in terms of the accuracy of their predictions rather than the realism of their assumptions (Niskanen, 1971: 191). This suggestion seems implausible because there is one very obvious difference between these two arguments. In the information-based argument politicians choose the level of output to be produced. In what might be called the blackmail argument, that bureaucrats can make ‘take-it-or-leave-it’ offers, this responsibility is however given to bureaucrats. Yet in both cases, the limits placed upon bureaucrat’s capacity to budget-maximize derive from the assumption that politicians know enough to prevent the total costs of bureaucratic output exceeding its total benefits. In the case of the information-based argument this assumption stops bureaucrats extracting too large a budget in return for any specified output. In the case of the blackmail argument, this assumption provides the cut-off point beyond which politicians will reject any budget demands.

**Evaluating the behavioural assumption**

In one of the first published critiques of *Bureaucracy and Representative Government*, Jean-Luc Migue and Gerard Belanger
(1974) argued that bureaucrats maximize not the size of their budget per se, but the size of their discretionary budget which they define as the difference between the total budget and the minimum costs of producing the output expected by the bureau’s sponsor. Although this discretionary budget cannot be appropriated as personal profit by the bureaucrat, it can, Migue and Belanger argue, be used to secure greater power, patronage, prestige, and so on. In a formal reassessment of his work, Niskanen (1991) has now accepted their argument and suggested that he was always uncomfortable with the behavioural assumption that bureaucrats are budget-maximizers. This concession might, however, be regarded as entailing a revision to, rather than a repudiation of, the original budget-maximizing argument.

The claim that bureaucrats want to maximize their discretionary income is, after all, still consistent with the underlying claim that bureaucrats are self-interested actors who attempt to maximize their salary, prerequisites of the office, public reputation, power and patronage. In a sense, all Niskanen is now arguing is that bureaucrats are more likely to achieve these goals by maximizing their discretionary budget. Furthermore, this concession does not significantly affect Niskanen’s overall conclusion that bureaucracies are inefficient. It does, however, alter the details of that argument. If bureaucrats maximize their total budget then, as we have seen, output will be too large. If bureaucrats maximize their discretionary budget then, depending upon the particular cost conditions, output may be either too large or too small (Niskanen, 1991: 22). But whether bureaucrats maximize their total budget or their discretionary budget, the bureau’s budget will still be too large. Indeed, Niskanen suggests that the position of a bureaucrat maximizing their discretionary budget is very similar to that of a budget-maximizing bureaucrat in a demand-constrained bureau.

In the case of a budget-constrained bureau (Figure 6.2), the bureau produces too much but is efficient in the limited sense that the total costs of the bureau are exactly equal to the total benefits of its production. So although the bureau is producing more than is optimal, there is no ‘fat’ in the budget and a detailed cost–benefit analysis will not reveal any scope for budget savings. In the case of a demand-constrained bureau (Figure 6.3), where there is a limit on the amount which can be produced, bureaucrats have an incentive to create budgetary slack and so inflate the overall size of their budget. A bureaucrat seeking to maximize the size of their discretionary budget has, Niskanen argues, exactly the same incentive.

The most interesting and plausible alternative to the assumption that bureaucrats maximize their discretionary income is that they are ‘bureau-shapers’. Patrick Dunleavy (1985, 1991) argues that senior bureaucrats care more about the kind of work they do than their terms and conditions. Bureaucrats prefer innovative work with longer time horizons and high discretion over routine work with short time horizons and low discretion; small-sized work units with cooperative working relationships over large-sized units with coercive work relationships; and work which entails proximity to political power centres and confers high-status social contacts to work in regional locations conferring low-status contacts (Dunleavy, 1991: 202). Senior bureaucrats will sometimes be able to achieve these goals by applying for new jobs or redefining their existing ones. At other times they will, however, act collectively to off-load or contract-out unattractive parts of their work. Far from attempting to maximize their budget and output, ‘bureau-shaping’ bureaucrats will sometimes welcome budget cuts.

Dunleavy presents bureau-shaping as a behavioural alternative to budget-maximizing. Oliver James (1995, 2003) suggests that senior bureaucrats may derive utility from both increases in their budget and interesting policy work and that changes in bureaucrat’s behaviour can be explained in terms of changes in the relative ‘prices’ of these two activities. In the 1980s governments across the world committed themselves to reducing public expenditure. This change in the external environment effectively raised the ‘price’ of budget-maximizing in the sense that investments by senior bureaucrats in efforts to increase their budget began to generate a lower return. Bureaucrats reacted rationally to this by placing a greater value upon policy work. It is for this reason, James argues, that British Civil Servants welcomed, against all expectations, the government’s 1988 proposals to split the Civil Service into a series of semi-autonomous ‘Next Steps’ agencies tasked with delivering services and a relatively small number of core departments focused upon policy advice.

A formal version of this argument is provided in Figure 6.4. Here, the preferences of senior bureaucrats over policy work and budget are shown in two indifference curves I_1 and I_2. Each of these curves show combinations of budget and policy work between which bureaucrats are indifferent. Whilst bureaucrats derive equal utility from any point on I_2, they prefer any point on I_1 to any point on I_2. Given the external constraint imposed by politicians (A–B) who set limits on both the total budget and the amount of time spent on policy advice, bureaucrats maximize their utility by choosing that combination of budget
and policy work which falls on the highest possible indifference curve. In Figure 6.4 this combination is one in which bureaucrats receive a budget of $X_1$ and spend $Y_1$ of their time on policy work. The cut-back management pursued in the 1980s manifests itself in a shift in the political constraint from A–B to A–C. At this point it requires a greater sacrifice of policy work in order to secure any given level of budget. Bureaucrats must now maximize their utility by spending a larger proportion of their time, $Y_2$, on policy work in return for a significantly lower budget of $X_2$.

**Evaluating the equilibrium argument**

One way in which the equilibrium argument might be defended is in terms of the instrumentalist claim that the accuracy of a model’s predictions matter more than the realism of its assumptions. In Niskanen’s case, the most significant prediction is of course that bureaucracies ‘supply an output up to twice that of a competitive industry faced by the same demand and cost conditions’. In assessing the strength of this prediction the first point to make is that *Bureaucracy and Representative Government* does not itself contain any tests of this prediction or even any indication of how it might be tested. The second point to make is that there is, however, plenty of evidence that private firms are *usually* able to run various services including airlines (Davies, 1981), bus services (McGuire and Van Cott, 1984) and nursing homes (Freech, 1985) more cheaply than their public and bureaucratic counterparts (see Mueller, 2003: 373–9 for a more detailed review). This may well tell us something significant about the differences between the public and private sector although it may of course only tell us that private firms pay lower wages and offer fewer employment rights than public bureaucracies. The most important point to make here, however, is that this kind of evidence does not really bear upon the prediction Niskanen is making about the behaviour of public bureaucracies and private firms. Indeed it must be doubted whether any test of his prediction is possible.

Niskanen suggests that public-sector bureaucracies will ‘supply an output up to twice that of a competitive industry faced by the same demand and cost conditions’ (emphasis added). Yet because demand for the goods supplied by public bureaucracies is transmitted through political mechanisms like voting and logrolling (see pp. 167–71), demand and cost conditions for such goods are not the same as they are for goods produced by privately-owned firms in competitive markets (Dowding, 1995: 48–50). Recall, in this context, Arrow’s argument that the results of attempts to aggregate individual preferences will depend upon the method of aggregation used. Even if individuals have the same preferences for goods and services as voters as they do as consumers, the aggregate benefit schedule of a bureaucratically-produced good may nevertheless differ from a privately-produced one because of the way in which these preferences are aggregated. At a more prosaic level, demand and cost conditions will also vary because governments routinely require public bureaucracies to provide and produce goods and services in particular ways. Governments often require public bureaucracies to provide the same level of service in remote, rural, areas as they do in metropolitan ones, or to purchase their capital equipment, particularly information technology, from national firms. For these reasons, private firms and public bureaucracies may indeed have different budgets and produce different levels of output. But this could be because public bureaucracies budget-maximize, because they face different demand and cost conditions, or both.

A second way in which the equilibrium argument might be defended
is in terms of the plausibility of its assumptions. The claim that bureaucrats can make take-it-or-leave-it offers is, in this respect, a non-starter. But what of Niskanen’s claim that bureaucrats possess and exploit a significant information advantage? As I have already indicated, this is a more plausible argument. Indeed it would be surprising if bureaucrats did not have more information about costs and outputs and the relationship between them given that in most government departments there are usually several hundred bureaucrats for every one politician or political advisor. Yet some of the specific claims Niskanen makes about the relationship between bureaucrats and politicians are nevertheless problematic.

Niskanen’s work was inspired by his experiences working in America and his model assumes that responsibility for setting and monitoring budgets is exercised, as it is in America, by legislative committees. At the time Niskanen was writing, in the early 1970s, it was a conventional piece of American political science wisdom that these committees were relatively ineffectual (see Clark, 1964). To this extent, his argument was a controversial one not so much because of what he said about the unequal relationship between bureaucrats and politicians but because of the way in which he said it. In the 1980s, however, this conventional wisdom was challenged. American political scientists operating within or on the edges of the rational choice paradigm began to argue that Congressional Committees actually ‘dominate’ the bureaucracy (see Shepsle and Weingast, 1994 for a general review).

1 Romer and Rosenthal (1978) and Bendor et al. (1985) suggest that politicians can control bureaucrats and prevent budget-maximizing by setting reversion budgets which bureaucrats will be forced to accept if their budget demands are rejected. If reversion budgets are set correctly, bureaucrats can be deterred from making excessive demands.

2 Miller and Moe (1983) suggest that politicians can effectively trick bureaucrats into revealing detailed information about minimal costs by asking them how much output they would be willing to provide at various per unit prices. In this way politicians can build-up a detailed picture of the bureaucrat’s supply curve. To the extent that this requires bureaucrats to reveal information politicians can then use to cut their budgets, this is implausible. Bureaucrats would surely attempt to mislead politicians about costs. But as Miller and Moe observe, their argument is no more implausible than assuming, as Niskanen does, that politicians will accept bureaucrat’s budget demands so long as total benefits are greater than or equal to benefits.

3 Congressional Committees cannot monitor and control bureaucratic performance by undertaking detailed ‘patrol’ exercises entailing the collection and analysis of huge amounts of information about costs and output. As McCubbins and Schwartz (1984) observe, they do not however need to do so. Legislative Committees can instead rely upon ‘alarms’ raised by constituents and interest groups to tell them when a bureaucracy is performing ineffectively.

4 McCubbins, Noll and Weingast (1987, 1989) argue that Congressional Committees control bureaucracies by setting their administrative rules and standard operating procedures. Consider, for example, the rule requiring agencies to give public notice of any intention they might have of changing the way some legislative policy is interpreted. This rule gives affected groups the opportunity to express any concerns they might have to the relevant Congressional Committee and that Committee the information necessary to then challenge the agency’s decision.

5 Weingast and Moran (1983) observe that Congressional Committees have the formal power to hire and fire senior bureaucrats, ‘ring-fence’ particular investments and hold investigations and public hearings into an agency’s performance. This, they argue, will usually be sufficient to ensure that bureaucrats abide by politicians’ preferences.

In recent years, the Congressional Dominance thesis has itself been subjected to criticism. One argument here is that politicians will often be reluctant to use the powers that they have. Politicians will not want to cut budgets or launch public hearings because the former would harm their constituents and the latter would generate too much adverse publicity. A second argument draws upon the existence of voting cycles. Bureaucrats will sometimes be able to evade political control because whilst a majority of the politicians on some Committee may have instructed the bureaucracy to behave in a particular way, another majority, composed of a different set of politicians, may nevertheless prefer the bureaucracy’s chosen course of action to that mandated by the Committee (Hammond and Miller, 1985). Finally, it has been argued that politicians will sometimes find it in their interests to grant a great deal of discretion to quasi-autonomous agencies because by doing so they can make it harder for subsequent administrations to
reverse their policy decisions (Horn, 1995: 10–18). Yet even if we want
to draw back from describing Congressional Committees as being
dominant, it is difficult to see how they might reasonably be portrayed
as being as weak as Niskanen suggests.

In introducing the equilibrium argument we followed Niskanen in
assuming that politicians accurately represent voters' demand for
particular goods and services. Congressional 'dominance' would, to
the extent that the thesis is correct, therefore seem to be a good thing.
Yet it is worth briefly noting that Niskanen (1975) argues that
members of Congressional Committees themselves favour higher
public expenditure than either the median member of Congress or the
median voter. This is because politicians will often sit on those commit-
tees whose policy remits are of the most immediate relevance to their
constituency. Politicians from rural areas will therefore dominate the
Committee on Agriculture and vote for larger farm subsidies whilst
politicians with large military bases in their constituency will dominate
the Committee on Armed Services and vote against defence cuts. As a
result, bureaucrats are sometimes pushing at an open door when they
demand higher budgets. For this reason we cannot conclude that
Congressional dominance necessarily prevents budget-maximizing.

Whatever we conclude about the effectiveness of American
Congressional Committees, it is worth emphasizing that in Australia,
New Zealand, Japan and most European countries, the primary
responsibility for budget control is exercised by finance ministries
rather than legislative committees. Because these ministries are large,
politically powerful and usually staffed by former bureaucrats, they are
in a far stronger position to collect information about minimum costs
than Congressional Committees. There is, in this respect, a related
point to make about the parochialism of Niskanen's argument. In the
American public service, senior positions are usually filled by political
appointees serving no more than four years, whilst in most European
countries these positions are filled by career bureaucrats. As Guy Peters
(1991) suggests, American bureaucrats may feel under a particular
pressure to secure large budget increases in order to make an immedi-
ate impact in their work. European bureaucrats, especially those who
expect to be rotated between departments, may have less interest in
budget-maximizing.

Bureaucracy and Representative Government may, for these
reasons, tell us more about the relationship between bureaucrats and
politicians in American that it does in the rest of the world. This may
not, however, be all. For it may be that Bureaucracy and

Representative Government only really tells us something about the
relationship between bureaucrats and politicians in one particular
American department during one particular period. Niskanen's work
was, it will be recalled, inspired by his experiences working in the
Department of Defense, yet this is hardly a typical department. The
sheer size of the Pentagon together with the inter-service rivalries which
stymie its decision-making, make this a particularly difficult bureau-
cracy for politicians to control (see the comments in Woodward, 2004:
15–18). One way in which such difficulties manifest themselves is in
cost over-runs in procurement programmes (Farrell, 1997: 161–7). Yet
it is not immediately clear that this constitutes evidence of budget-
maximizing. After all, these cost over-runs have been incurred on
programmes in which private firms like General Dynamics and Boeing
have been contracted to provide particular weapons systems.

Niskanen's work was inspired not simply by his experiences working
in the Department of Defense, but his experiences working there in
the 1960s. Having been accused of being soft on defence during his
Presidential campaign against Richard Nixon, Kennedy entered office
in 1961 determined to establish more hawkish credentials (Giglio,
1991: 45). He did this partly by continuing to sponsor or at least turn
a blind eye to the CIA's attempts to assassinate Fidel Castro in the
aftermath of the Bay of Pigs Fiasco (see Freedman, 2000: 123–39). He
also did it by authorizing significant increases in defence expenditure
during his first two years in office. Against this background, it is
perhaps not surprising that Niskanen's then colleagues in the Pentagon
should have seemed so keen to maximize their budgets. But we cannot
simply assume that conditions which held in the 1960s continued to
hold during later periods. Indeed, as Robert Goodin (1982) observes,
new institutions like the Congressional Budget Office and new Budget
Committees in both the House of Representatives and Senate made
budget-maximizing much more difficult in the very different political
and economic climate of the 1970s.

Assessment

In the concluding chapters of Bureaucracy and Representative
Government, Niskanen (1971: 195–230) advances the merits of
three reform proposals. The first is to give bureaucrats who reduce
their budgets higher wages, a 'one-off' prize payment, or increased
discretionary budgets. The second is to change the composition of
Congressional Committees in such a way as to make them more representative of the views of the median legislature. The third and most important is to ensure greater competition by requiring bureaucracies to compete either with each other or privately-owned firms to provide services. The first of these reforms is intended to reduce the incentive bureaucrats have to budget-maximize. The second is intended to increase the incentive politicians have to prevent budget-maximizing. The third is intended to force bureaucrats to reveal more information about the minimum costs of providing particular levels of output.

At a time when the New Right was in the ascendancy in both Britain and America (Cockett, 1995), *Bureaucracy and Representative Government* proved hugely influential. Having been popularized by think-tanks like the Institute of Economic Affairs (Niskanen, 1973), Niskanen’s analysis, together with more general arguments about the limits of state planning (Hayek, 1982), the importance of ‘hard’ budget constraints (Kornai, 1980), and the dangers of ‘government overload’ (Brittan, 1975; King, 1975) and ‘crowding-out’ (Bacon and Eltis, 1976), contributed to the development of and provided a part of the justification for the New Public Management.

As it has been described by Christopher Pollitt (2002), New Public Management involves (i) a shift in the focus of management systems from inputs and processes to outputs and outcomes; (ii) a shift towards greater measurement of results; (iii) a preference for ‘leaner’, ‘flatter’ and more autonomous organizations; (iv) a substitution of contract or contract-like relationships for traditional hierarchies; (vi) a much greater use of market or market-like mechanisms for the delivery of public services; and (vii) a broadening and blurring of the frontier between the public and private sectors (see also Hood, 1991). In America, Britain, New Zealand, Australia, Canada and Sweden and, to a lesser extent, in France, Germany and the European Commission, the application of such ideas over the last twenty years has entailed privatization, contracting-out, the use of performance indicators and tighter budgetary control systems, and the creation of ‘internal’ markets and explaining and predicting where traffic jams will appear on a morning. They publish an impressive academic paper and are invited on to the radio to advise drivers which roads to avoid. Listeners heed the predictions and change their routes so causing traffic jams to appear elsewhere.

How does this apply to rational choice theory? Clearly the explanations and predictions rational choice theorists make about the world make a difference to that world. I have, for example, already argued that arguments about state failure provided intellectual ammunition and a burgeoning policy agenda for the New Right in the 1970s and 1980s. Yet critics would argue that such arguments amounted to self-fulfilling prophecies. In so far as they presented political actors as being entirely self-interested, they led actors to believe that everyone else was behaving in a self-interested way so encouraging them to behave in the same way (Stretton and Orchard, 1994). Recall here the argument about the nature of equilibrium. In the social sciences equilibrium is equilibrium of expectations; if everyone expects everyone else to drive on the right then everyone has a reason to drive on the right so making driving on the right the equilibrium outcome. If everyone expects everyone else to act in a self-interested way, then acting in a self-interested way might be an equilibrium strategy. By changing people’s expectations, rational choice may actually change people’s actions. In the case of the ‘traffic-jam’ problem, social science predictions create the conditions for their own falsification. In the case of rational choice theory, the predictions theorists made may have created the conditions for their own corroboration.
semi-autonomous executive agencies (see Pollitt and Bouckaert, 2000: 192–298 for detailed country-by-country reviews).

As a result of the spread of the New Public Management, many of the reforms first advocated by Niskanen have now been implemented. Bureaucrats’ terms and conditions have been revised so as to reward them for controlling costs. Congressional Committees have now been restructured and responsibility for budget-setting given to separate House and Senate Committees. Ministers are now given far more information about costs and outputs (Aucion, 1991). Finally, privatization, contracting-out and the creation of internal markets have ensured greater competition. One way in which the social sciences differ from the natural sciences is in terms of their ‘reflexivity’ (Box 6.3). What social scientists say about the world can sometimes make a difference to that world. Niskanen’s work offers a clear example of this phenomenon. Although Bureaucracy and Representative Government has come under sustained academic attack, and although Niskanen himself no longer maintains that bureaucrats are budget-maximizers, Niskanen’s argument has nevertheless influenced the way in which bureaucracies are structured and public services delivered.

Chapter 7

Gordon Tullock, Rent-Seeking and Constitutions

Overview: Business firms and interest-groups are influential actors in the policy process. In ‘The Welfare Costs of Tariffs, Monopolies and Theft’, Gordon Tullock (1967) argued that the way in which they exercise this influence is economically crippling. Rent-seeking takes place when firms or interest-groups try to extract special privileges from government. Rent-seeking is damaging because it entails the expenditure of resources which might otherwise have been used to benefit consumers. In this chapter I outline Tullock’s original argument and then explain why rent-seeking has proven to be such an influential theory. The rest of the chapter examines two questions. First, and given the claim that rent-seeking is pervasive, why is the rent-seeking ‘industry’ of lobbying firms, public-relations companies and lawyers so small? Second, and given the claim that rent-seeking is so damaging, how might it be reduced or even eliminated? The second of these questions requires a foray into a second area of rational choice theory, Constitutional Political Economy, which Tullock, together with James Buchanan, pioneered in The Calculus of Consent (1962).

Setting the stage: the politics of pressure

During the 1950s and 1960s the empirical and normative study of interest groups was dominated by pluralists like David Truman (1951) and Robert Dahl (1956). Although pluralism is an easier position to caricature than characterize, pluralists believe that power should be dispersed throughout society, that public participation in political processes should be encouraged, and that government policy should command the consent of the public (Baggott, 1995: 13). Pluralists argue that interest-groups are important policy actors and that they are instrumental in achieving these goals. Interest groups allow people to express their preferences over policy issues on a sustained basis and to become personally involved in the political process. They also act as