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*Public and Private Bureaucracies:
A Transaction Cost Economics Assessment*

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Bureaucracy is widely regarded with contempt and is (correctly) perceived to be a grave burden in planned economies, where bureaucracy is especially pervasive. This paper examines public and private bureaus in decentralized economies where the institutional environment communicates confidence to investors and traders alike. Its very real disabilities (low powered incentives, slow responsiveness, rules and regulations) notwithstanding, the public bureau turns out to be the preferred form of governance for organizing certain types of "nonstandard transactions." Used appropriately, the public bureau deserves not scorn but respect. Used inappropriately, the public bureau is the source of avoidable waste. Accordingly, a place needs to be made for public bureaus, but public bureaus need also to be kept in their place.

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Public and Private Bureaus:

Executive Summary

Oliver E. Williamson

Bureaucracy in general and public bureaucracy in particular suffer from a bad name. Sometimes that bad name is well-deserved, but sometimes it reflects a failure to appreciate that the problems with which public and private bureaus deal are intrinsically difficult.

This paper examines bureaucracy from the transaction cost economics perspective, according to which the public bureau is one of several governance structures and is evaluated comparatively in relation to other feasible modes of governance. Although the main comparison is between public and private bureaus, comparisons with market and hybrid forms of contracting and with nonprofit organization are included as well. Redistributive purposes aside, the public bureau is reserved for very special transactions and is usefully regarded as the organization form of last resort.

That it is employed as a last resort reflects both its weaknesses and its strengths--which, as it turns out, are both attributable to the very low powered incentives that operate in public bureaus. These low powered incentives and the associated bureaucratic cost burdens that are borne by public bureaus are defining characteristics and indwelling features. Both obtain because the public bureau is a creature of politics and is embedded in politics and because the contract law of public bureaus (Civil Service Law in combination with administrative law) elicit these properties. Also, and related, the public bureau, as compared with the private bureau, is subject to less competition from the product market and still less competition from capital markets.

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The very real incentive limitations of the public bureau for the delivery of standard goods and services notwithstanding, there are some goods and services that benefit from the very low powered incentives and/or confidence infusing properties of public bureaus. Nonstandard transactions for which the public bureau enjoys comparative advantages include (1) sovereign transactions, (2) emergency preparedness, (3) some quality assurance measures, and (4) redistribution.

The analysis proceeds comparatively and employs a remedialness standard, according to which hypothetical ideals are operationally irrelevant. Attention is therefore focused on alternatives that are feasible, implementable, and the source of expected net gains. Benign governance is disallowed.

Public and Private Bureaus:

A Transaction Cost Economics Assessment

Oliver E. Williamson*

James Q. Wilson, whose recent book on Bureaucracy provides basic background for this paper, remarks that "The idea of transaction costs has not been applied, so far as I know, to government activities. But I see no reason why it should not be" (1989, p. 358). Wilson is correct in his impression that transaction cost economics has principally been applied to the private sector. His suggestion that it could be fruitfully applied to public sector bureaucracy is one with which I concur.

The observation, moreover, that "People matter, but organization matters also, and tasks matter most of all" (Wilson, 1989, p. 173) anticipates much of the argument of this paper. Expressed in transaction cost terms, the argument is this: behavioral assumptions matter, but governance structures matter also, and transactions matter most of all.

To be sure, it is transaction attributes in combination with behavioral attributes that bring about the complications to which nonstandard governance structures are the response--where by nonstandard I mean departures from simple market mediated exchange. Also, provision needs to be made for the "institutional environment"--the so-called rules of the game within which governance structures are embedded (Davis and North, 1971, pp. 5-6). The recent literature in Positive Political Theory¹ is thereby implicated.

This paper examines bureaucracy from a combined transaction cost economics/Positive Political Theory perspective, with special emphasis on the former. Indeed, Section 2 aside, where I examine how changes in the polity and the judiciary influence confidence in both investment and contract, I assume that a favorable institutional environment--one that imparts confidence to investors and traders--is in place. Given that the institutional environment is supportive in these respects, the focus is on the relation

between transactions on the one hand and governance structures on the other. The argument is that simpler and more spontaneous forms of organization give way to more complex and intentional forms of organization if and as "added complications" arise.

Candidate transactions that pose added strains and/or present added needs to which more complex governance may be warranted include (1) natural monopoly, (2) sovereign transactions, (3) emergency planning, (4) quality assurance, and (5) redistribution. The criterion for supplanting one form of organization by another is that of remediableness: Can the purposes in question be accomplished by an alternative form of organization that is feasible and to which expected net gains can be projected? Ideal forms of organization that cannot be implemented are, under this criterion, operationally irrelevant.

A rank ordering approach to governance is the result--according to which private sector governance comes first (within which sector the order is market, then hybrid, followed by hierarchy); the public bureau is the organization form of last resort; and nonprofits, regulation, and franchise bidding are located in between. Such a rank ordering conception is at variance with views of organization that regard public and private bureaus on a parity and/or that contend that what is going on out there is largely adventitious.

The proposition that behavioral assumptions matter is the subject of Section 1. The institutional environment is described in Section 2. Some of the key respects in which governance structures matter are examined in Section 3. The complications that attend the five types of transactions listed above are described and governance structure responses are prescribed in Section 4. Concluding remarks follow.

1. Behavioral Assumptions Matter

Although behavioral assumptions are frequently scanted in economics, transaction cost economics subscribes to the proposition that "Nothing is more fundamental in setting our research agenda and informing our research methods than our view of the nature of the human beings whose behavior we are studying" (Simon, 1985, p. 303). The cognitive and self-interestedness features of human behavior on which transaction cost economics focuses are described as bounded rationality and opportunism, respectively. All complex contracts are unavoidably incomplete, by reason of bounded rationality, and contract as mere promise (unsupported by credible commitments) poses hazards, because of opportunism. Economizing on bounded rationality and mitigating opportunism are thus emphasized in the transaction cost economics setup.

It could be argued, and sometimes is, that public and private bureaucrats differ in bounded rationality and opportunism respects. The directions of the effects are disputed, however, and I will assume that bureaucrats, be they in public or private bureaus, are indistinguishable in their behavioral attributes. That is not innocuous. It has ramifications both for the concept of benign governance and the remediableness standard.

1.1 benign governance

The efficacy of public sector governance is often supported by the assumption that public bureaus are reliably benign. Underlying the traditional policy prescriptions of public economics "is the notion of government as a benevolent guardian, hampered only by ignorance of proper economic policy as it seeks disinterestedly to maximize a Benthamite social welfare function" (Krueger, 1990, p. 172). What is the basis for this? And what are the ramifications if the benevolence of public bureaus is problematic (or even naive and/or disingenuous)?

One justification for ascribing benevolent properties to the government is that this is analytically convenient. Another is that some people really believe that "the most intractable problems [will] give way before the resolute assault of intelligent, committed people" (Morris, 1980, p. 23). The latter is rank hubris and the former, as Ronald Coase explains, is at best a starting place (1964, p. 175; emphasis added):

Contemplation of an optimal system may provide techniques of analysis that would otherwise have been missed and, in certain special cases, it may go far to providing a solution. But in general its influence has been pernicious. It has directed economists' attention away from the main question, which is how alternative arrangements will actually work in practice. It has led economists to derive conclusions for economic policy from a study of an abstract of a market situation. It is no accident that in the literature...we find a category "market failure" but no category "government failure." Until we realize that we are choosing between social arrangements which are all more-or-less failures, we are not likely to make much headway.

It is elementary that intelligent people need to come to terms with their cognitive limitations and that committed people are rarely disinterested-- which is to say that most have an agenda. Also, if all feasible forms of organization are flawed, then references to benign government, costless regulation, omniscient courts, and the like are operationally irrelevant. Comparative institutional economics is always and everywhere beset with tradeoffs.

1.2 remediableness

The concept of remediableness has a long history. Both E.A.G. Robinson (1934) and Harold Demsetz (1967) made perceptive reference to the analytical poverty of "nirvana economics"--which entailed comparisons of actual forms of organization with ideal forms. At best, however, an ideal standard is a starting place. Issues of feasibility and implementation need to be faced.

All feasible forms of organization being subject to "failure," relevant operational choices and final comparisons are between alternative flawed forms.² Also, if one of the alternatives under comparison is an extant form, there is an additional complication. That is because extant forms are, in effect, privileged.

Thus even if the delivery of X by mode A is judged to be inefficient in relation to mode B on a simple side-by-side comparison, that does not suffice if mode A is an extant form. In that event it needs further to be demonstrated that a move from A to B can be accomplished with net gains. Prevailing conditions for which no net gain alternative can be described are irremediable--which is to say efficient.

Lapses into ideal but operationally irrelevant reasoning will be avoided by (1) recognizing that it is impossible to do better than one's best, (2) insisting that all of the finalists in an organization form competition meet the test of feasibility, (3) symmetrically exposing the weaknesses as well as the strengths of all proposed feasible forms, and (4) describing and costing out the mechanisms of any proposed reorganization. Such precautions seem to be reasonable, transparent, even beyond dispute; yet all are frequently violated.³

A symmetrical and unvarnished approach to all forms of economic organization is everywhere the pressing need. As Robert Michels perceptively concluded from his study of oligarchy, "nothing but a serene and

frank examination of the oligarchical dangers of democracy will enable us to minimize these dangers" (1962, p. 370). The lesson applies more generally: informed choice among alternative forms of organization requires a serene and frank examination of the powers and limits of all.

2. The Institutional Environment

Lance Davis and Douglass North have described the institutional environment as "the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution. Rules governing elections, property rights, and the right of contract are examples" (1971, p. 6). Politics and the political process are centrally implicated. This paper draws on recent developments in Positive Political Theory of three kinds: those that relate to credible commitments, those that influence the design of public sector bureaus, and those that arise in conjunction with redistribution. This last is developed in Section 4.5.

2.1 credible commitments

The idea of credible commitments plays a prominent role in the study of private ordering, the conditions of the institutional environment held constant (Telser, 1981; Klein and Leffler, 1981; Williamson, 1983). Positive political theory also appeals to credible commitments, but moves the analysis up to the level of the institutional environment. Barry Weingast's treatment of federalism (1992, 1993) and the recent summary assessment of privatization by Brian Levy and Pablo Spiller (1993) are particularly germane.

As developed by Levy and Spiller, credibility will be promoted by combining a fragmented polity with a strong judiciary. The latter is unsurprising: greater investment and contractual confidence are "obviously" supported by an independent, informed, and principled judiciary. The surprise

is that a strong polity is a threat to credibility. As Weingast explains (1992, p. 1):

The fundamental political dilemma of an economic system is this: A government strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens. Thriving markets require not only the appropriate system of property rights and a law of contracts, but a secure political foundation that places strong limits on the ability of the state to confiscate wealth.

As between parliamentary/separation of powers and unified/federalism regimes, the former member in each pair is recognized as the stronger polity yet poses the greater commitment hazard (Moe and Caldwell, 1993).

Weingast's treatment of federalism relies on William Riker (1964), who defines a political system as federal if it has three characteristics: "a hierarchy of governments, i.e., 'two levels of governments rule the same land and people'; a delineated scope of authority so that each level of government is autonomous in its own, well-defined sphere of political authority; and an institutionalized degree of autonomy of each government in its own sphere of authority" (Weingast, 1992, p. 10). To this Weingast adds a fourth characteristic: a federal system is said to be market-preserving if "the authority to regulate is not vested with the highest political government in the hierarchy and ...the lower governments are prevented from using their regulatory authority to erect trade barriers against the goods and services from other political units" (Weingast, 1992, p. 10). These four provisions, combined with voting with one's feet--political competition (Tiebout, 1956)--infuse credibility into a federal regime.

To be sure, some of the hazards of a unified polity can be checked by a strong judiciary. In a monarchy, for example, credibility will be enhanced if

a monarch who has made the law "may not make it arbitrarily, and until he has remade it--lawfully--he is bound by it" (Berman, 1983, p. 9). But an even stronger credibility regime is one that combines a strong judiciary with a fragmented polity.

If, as between polity and judiciary, the characteristics of the judiciary are the more important in credibility infusing respects (Levy and Spillar, 1993), then the following rank ordering of credibility obtains:

	<u>judiciary</u>	<u>polity</u>	<u>credibility</u>
(1)	strong	federal	strongest
(2)	strong	unified	strong
(3)	weak	federal	weak
(4)	weak	unified	weakest

2.2 inefficiency by design

Although public agencies are often criticized because they are rule-bound and needlessly inefficient, Terry Moe (1990a) observes that many of the "apparent" inefficiencies of public bureaus are the product of farsighted design efforts. Interestingly, inefficiency by design occurs in the private sector as well (Teece, 1986; Heide and John, 1988; Helper and Levine, 1992). Politics is both similar and different.

The distinctive features that Moe ascribes to politics are the need for compromise and the insecurity of political property rights. Both manifest themselves in bureau design. The design of the Occupational Safety and Health Administration (OSHA) is an example of inefficiency due to compromise (Moe, 1990, p. 126):

If business firms were allowed to help design OSHA, they would structure it in a way that it could not do its job. They would try to cripple it.

This is not a hypothetical case. Interest groups representing business actually did participate in the design of OSHA,...[and] OSHA is an administrative nightmare, in large measure because some of its influential designers fully intended to endow it with structures that would not work.

Politics also differs in the degree to which it is a purposeful effort to award favors. Although the benign tradition holds that bureaus represent "all of the people, all of the time," Realpolitik advises that "most political institutions are not arrangements for mutual advantage, but vehicles by which winners pursue their own interests at the expense of others" (Moe and Caldwell, 1993, p. 4). Bureaus are often the instrument through which winners deliver political favors.

Because political property rights are insecure, forward looking politicians will recognize that those very same bureaus through which favors are awarded to a target population could become instruments for reversing earlier actions (perhaps even to reward the opposition) by successor administrations. Agencies will therefore be designed with reference to both immediate benefits (which favors responsive mechanisms) and possible future losses (which often favors crafting inertia into the system). The creation of a bureau will therefore be attended by some degree of (apparent) design inefficiency--that being the forward thinking way to protect weak political property rights (Moe, 1990a, 1990b).

Thus although inefficiency by design figures in both the public and private bureau calculus, it is more prominent in the former--which is one of the reasons why public bureaus so often labor under a greater bureaucratic cost burden.⁴

3. Governance Structures Matter

Herbert Simon contends that "careful comparative studies have generally found it hard to identify systematic differences in productivity and efficiency between profit-making, nonprofit, and publicly-controlled organizations" (Simon, 1991, p. 38). The supporting empirical studies by Burton Weisbrod (1988, 1989) on which Simon relies, however, do not deal with a random sample of transactions but focus instead on "hard to measure" services--health care being the leading example. Albeit common for services such as health care to be concurrently provided by both public and private bureaus,⁵ side-by-side competition in which for-profit, nonprofit, and government bureaus are all present in significant degree is the exception and not the rule.⁶

The puzzle to be explained is why some transactions are organized predominantly by one set of governance structures while other transactions are organized predominantly by another. Transaction cost economics explains the predominant alignments in terms of the differential competence of governance structures to serve the varying needs of transactions.

Private ordering governance has been described elsewhere (Williamson, 1991) in terms of five attributes. This section begins with a brief sketch of these attributes and then compares public and private bureaus in these five respects. Additional contextual features are introduced in 3.3.

3.1 the five attributes

Transaction cost economics describes each generic mode of private sector governance--market, hybrid, and hierarchy--by three clusters of attributes: instruments, performance, and contract law supports. The instruments are incentive intensity and administrative controls. Incentives are stronger and

administrative controls are less extensive in transactions between firms (markets) than within (hierarchies).

Performance is described in terms of adaptive efficacy, of which two types are distinguished: autonomous or Hayekian adaptation (where markets excel) and cooperative or Barnardian adaptation (where hierarchy enjoys the advantage).

The contract law hypothesis out of which transaction cost economics works is that each generic mode of governance is supported by a distinctive form of contract law. The contract laws of market, hybrid, and hierarchy are classical, neoclassical, and forbearance law, respectively (Macneil, 1974, 1978; Williamson, 1991).

As shown in Table 1, markets and hierarchies are polar opposites in all five attribute respects and hybrid forms of organization (various types of long-term contracting, franchising, and the like) are located in between. The following points, which are developed elsewhere (Williamson, 1991), are especially pertinent to this paper:

- (1) Changes in asset specificity (from little, to some, to much) are principally responsible for changes in the adaptive needs of transactions (from mainly autonomous, to mixed, to mainly cooperative), which in turn are fundamentally implicated in the decision to organize different transactions by different governance structures.
- (2) A crucial reason why markets and hierarchies differ in discrete structural respects is that the contract law of hierarchy (forbearance) supports low-powered incentives and fiat. But for fiat--which obtains because the courts refuse to hear internal disputes between divisions--hierarchy would have much

less of an advantage over markets as an instrument for accomplishing cooperative adaptation.⁷

3.2 the comparisons

The foregoing is by way of introduction. The object is to compare public and private bureaus in these five respects.

(a) incentives

Not only are public bureaucrats almost wholly on salary (there is almost no merit pay),⁸ but, unlike private firms, "government agencies cannot lawfully retain and devote to the private benefit of their members the earnings of the organization" (Wilson, 1989, p. 115). Expressed in incentive intensity terms, public bureaus have very low powered incentives. Although it could be argued that public bureaus have very low powered incentives because that is the appropriate way to manage the "hard to measure" services that are assigned to them (Holmstrom and Milgrom, 1991; Tirole, 1993), I would argue that (1) hard to measure services are assigned to public bureaus because they have especially low powered incentives and (2) these low powered incentives are an indwelling feature. With reference to the latter, the argument is this: efforts to infuse high powered incentives into public bureaus will fail for lack of credibility.

The credibility of high powered incentive schemes is jeopardized by (1) the weakness of political property rights, whence future "promises" to pay for exceptional performance are insecure, (2) the fragmentation of the polity (bureaus have multiple masters), (3) the contract law of bureaus--especially Civil Service law (see 3.2(e), below), and (4) the monopoly status that is often conferred on bureaus (although this last is partly explained by the weakness of incentives to which public bureaus are subject). It is these, rather than difficulties of measurement (which, of course, would be

experienced by private bureaus as well if hard to measure services were assigned to the private sector) that are the key features.

(b) controls

Controls proliferate in public agencies. The added controls in public as compared with private bureaus are partly because, holding the nature of the task constant, public bureaus have weak incentives. More importantly, however, public bureaus are beset by politics. Also, but this steps outside of governance and implicates . . . attributes of transactions, many of the tasks that are assigned to public bureaus are difficult to manage. This last is discussed in 4.2, below.

The incentive argument is straight-forward: weak incentives invite slack in organization to which added controls arise as a means by which to mitigate slack. As with private bureaus, however, so with public bureaus: efforts to exercise control have both intended and unintended consequences, where the latter give rise to added demands for control (March and Simon, 1958, pp. 36-47). Herbert Kaufman explains: "As more constraints are imposed, rigidities fixing agencies in their established ways intensify. As a result, complaints that [agencies] do not respond to controls also intensify. Further controls, checkpoints, and clearances are therefore introduced" (1981, p. 192).

Costly consequences of several kinds obtain. First and most obvious is that rules are costly to create and enforce. Second, rules are a two-edged sword: not only do they operate as controls, but working-to-rules becomes a source of defensibility (Cyert and March, 1963). Additionally, and related, means come to be valued over ends (the "goal displacement" to which Robert K. Merton (1940) and other sociologists have referred). Finally, rules are applied by public agencies in especially mechanical ways (Wilson, 1989, pp. 342-343):

An inspector from OSHA charged with enforcing rules will evaluate the physical aspects of a factory: the ventilation, guardrails, safety devices. By contrast, an inspector from an insurance company charged with assessing the insurability of the firm will evaluate the attitude and policies of management: its safety consciousness. The difference...is important [if] 'most workplace injuries are not caused by violations of [rules], and even fewer are caused by violations that inspectors can detect'.⁹

An even more important reason than weak incentives for the proliferation of controls in a bureaucracy is "democratic politics" (Wilson, 1989, p. 121). (The purported bureaucratic "love of red tape" assumes that public bureaucrats differ from private bureaucrats in behavioral respects. As previously remarked, that plays no role in my assessment.) Both the fragmentation of democratic politics and the weakness of political property rights are implicated. Wilson speaks to the first of these as follows: "Many, if not most, of the difficulties we experience in dealing with government agencies arise from the agencies being part of a fragmented and open political system" (Wilson, 1989, p. 376).¹⁰

The fragmentation of democratic politics in the U.S. is not adventitious: public bureaus have many masters by constitutional design. Not only are the president and Congress "rivals for control" (Wilson, 1989, p. 257), but the courts have become progressively more intrusive (Wilson, 1989, chap. 15).

Congressional controls--which take the form of legislation, appropriations, hearings, investigations, personal interventions, friendly advice--are nothing short of "awesome" (Wilson, 1989, p. 236). Although it still comes as a surprise to some, "government agencies in this country are under the control of the very legislators who so regularly denounce them"

(Wilson, 1989, p. 235). That is simply the way the game of congressional politics is played.

The president, moreover, is not a passive figure. Not only does the president exercise controls through the choice of agency heads, but changes in procedures, reorganization, and coordination requirements are used as presidential control devices (Wilson, 1989, p. 260).

Because, moreover, efforts by one control agent (e.g., Congress) to promote its purposes invite responses by rival control agents (e.g., the president) to neutralize or offset the advantage, public bureau controls further proliferate. Also, as discussed in Section 2.2, above, public bureaus are the product of compromise¹¹ and political property rights are especially insecure. Both result in the convoluted organization of bureaus (Moe, 1990a).

(c) autonomous adaptation

The weak incentives and bureaucratic propensities of the vertically integrated firm are responsible for the comparative disadvantages of hierarchies in relation to markets in autonomous adaptation respects. The still weaker incentives and greater bureaucratic burdens of the public bureau make it even worse as an instrument of autonomous adaptation.

(d) cooperative adaptation

The need for cooperative adaptation is ascribed principally to the condition of asset specificity in the transaction cost economics scheme of things. Because high-powered incentives get in the way of coordinated adaptation, markets give way to hierarchies as bilateral dependency becomes great. If, however, public bureaus have still weaker incentives, might they be even better in cooperative adaptation respects? That varies with the circumstances.

In the context of complex and wide-ranging systems in which real-time responsiveness is crucial--such as war-time planning, of which the Manhattan

Project for developing the atomic bomb is an example--reliance on bureaucratic command and control with very low-powered incentives has a lot to recommend it. Emergency response systems are obviously a special case, however.

The rule proliferation to which public bureaus are subject is, for more routine events, an impediment to adaptation of both autonomous and cooperative kinds. Additionally, as discussed above, bureaus are often maladaptive because of the needs for political compromise and by strategic efforts to protect weak political property rights. Wilson concludes that "government agencies are far less flexible than formal organizations generally" (1989, p. 368).

(e) contract law

The effective contract law of (private) bureaucracy is that of forbearance, whereupon courts will refuse to hear internal disputes between divisions to which they would grant standing if identical technical disputes were to arise in contracts between firms. Firms therefore become their own court of ultimate appeal and, for that reason, are able to exercise fiat that markets cannot. Indeed, that is a leading reason why hierarchy is superior to the market in making cooperative adaptations.

Public bureaus are also forbearance law regimes. But there are two other contract law features that distinguish the public bureau: civil service law and administrative law.

(i) civil service law

The Civil Service Act of 1883 was intended to substitute merit employment for a spoils system that, beginning with Andrew Jackson's active espousal of it (Kaufman, 1965, p. 20), had grown rampant under Abraham Lincoln (Kaufman, 1965, p. 22). Reform efforts by Presidents Grant and Hayes made little headway. The assassination of President Garfield by a man who thought that he

should have received an appointment provided added impetus (Kaufman, 1965, p. 23).

Because Jackson perceived most public duties to be "plain and simple," little productivity was lost by rewarding political supporters with government jobs (Kaufman, 1965, p. 29). Yet even prior to Civil Service, the employment of some federal workers continued across successive administrations, presumably because they had acquired specialized competence and knowledge-- which is to say that human asset specificity was sometimes operative and sometimes respected (Kaufman, 1965, p. 29). That fraction, however, was evidently small: when Civil Service was first introduced, only 10 percent of the federal employees were covered (Kaufman, 1965, p. 40).

Gradually but relentlessly, coverage was increased. The Civil Service grew to 85 percent of federal (nonmilitary) employment by 1950 and has remained above that level since. Partly that growth is a reflection of the progressive growth of job specific skills, but much of it is a reflection of the difficulty of maintaining differentiated employment relations within a single organization.

To be sure, the federal government is a series of semi-autonomous and very different departments rather than a unified hierarchy. Moreover, some departments can and have opted out of Civil Service--as in the case of the career foreign service.¹² The original purpose of Civil Service was to substitute a merit screen for the spoils system. That accomplished, concerns over internal due process followed naturally and Civil Service work rules have proliferated (Kaufman, 1965, p. 53). The resulting job protection is broad and deep: "it is not impossible to fire a government employee. But it is very difficult" (Wilson, 1989, p. 145).

More generally, the argument is that Civil Service procedures and protections in government bureaus go beyond those afforded in private bureaus, with the result that controls proliferate and incentive intensity is weak.

(ii) administrative law

The use of administrative law as an instrument by which the courts could control agencies, by requiring agencies to follow procedures, is of more recent origin: "Once it was difficult to use the courts to alter the discretionary decisions of executive agencies; now it is relatively easy" (Wilson, 1989, p. 279). Not only is "standing" now awarded to those who have very attenuated relations with an administrative decision (Wilson, 1989, pp. 279-280), but the line between "law" and "policy" has become vague (Wilson, 1989, p. 280). Delays are the combined result of court reviews and associated efforts by bureaus to build a record that will withstand demands that decisions "not only be nonarbitrary and free of caprice but...supported by 'substantial evidence' set forth in a written record" (Wilson, 1989, p. 282). Bureaucratic costs are comparatively higher in public bureaus for this reason as well.

Summarizing the foregoing, public and private bureaus compare as follows: incentives are weaker and administrative controls are greater in public bureaus; adaptation, in both autonomous and cooperative respects, is slower and more maladaptive in public bureaus; and bureaucratization in the public bureau is encouraged by the contract laws--Civil Service and administrative--that apply to public bureaus. To that grim assessment, however, there is a caveat: the comparison applies strictly to "standard transactions," by which I mean those that are described by the standard triple of frequency, uncertainty, and asset specificity.

3.3 context

Not only does the general institutional environment (as described in Section 2 matter), but the particular environment within which public and private bureaus operation is also pertinent. Competition in both product and capital markets as well as "atmospherics" are germane.

(a) competition in the product market

The general argument here is that we should expect economizing efforts "to be most clearly exhibited in industries where entry is easiest and the struggle for survival keenest" (Koopmans, 1957, p. 141).¹³ Public bureaus rarely compete in a head-to-head way with private bureaus. Instead, competition tends to be of a niche (differentiated product) kind. Lest there be destructive competition, public bureaus--such as the postoffice and Social Security Administration--are often afforded insularity by grants of monopoly. Rival forms of private sector organization are then restricted to the fringes (Federal Express and United Parcel being examples).

In the degree to which competition in the product market contributes to incentive intensity, the private bureau enjoys the advantage.

(b) competition in the capital market

Private bureaus (firms) are subject to a whole series of capital market controls--including the use of debt and equity as instruments of governance (Williamson, 1988) and the use of organization form as a means by which to control managerial discretion (Williamson, 1981). Voting and ownership differences in public and private bureaus are especially significant. Unlike the market for corporate control (Manne, 1965), where egregious excesses of expense in the private sector invite contests for control, there is no corresponding market whereby particular public bureaus¹⁴--as opposed to political contests where newly elected officials administer the government as a whole--are taken over and expense excesses are squeezed out. (This is not

to say that there are no checks or no oversight of the public bureau. Tiebout checks and electoral competition are not bureau-specific, however. And oversight by politicians of the public bureau and economic oversight of the private bureau are very different.)

Thus whereas the private bureau is free-standing and can be taken over by concentrating ownership under a one-share one-vote rule, the public bureau is embedded within the government, the whole of which must be taken over under a one-person one-vote rule. Lapses of inefficiency in private bureaus invite redress because the new owners, who perceive and credibly commit to correct the condition, immediately realize the discounted value of the future stream of net receipts (Alchian and Demsetz, 1972, p. 790). There being no counterpart public sector value realization (capitalization) process, the incentive intensity differences between public and private bureaus are magnified by competition in the capital market.

(c) identification

Identification--pride in work and organizational loyalty--has long been featured by Simon (1947), who more recently observes that (1991, p. 36):

Docility is used to inculcate individuals with organizational pride and loyalty. These motives are based upon a discrimination between a "we" and a "they." Identification with the "we," which may be a family, a company, a city, a nation, or the local baseball team, allows individuals to experience satisfactions (to gain utility) from successes of the unit thus selected. Thus, organizational identification becomes a motivation for employees to work actively for organizational goals. Of course, identification is not an exclusive source of motivation; it exists side by side with material rewards and enforcement mechanisms that are part of the employment contract. But a realistic picture of how organizations operate must

include the importance of identification in the motivations of employees.

For comparative institutional purposes, the question is how does the employment relation in public and private bureau compare. Specifically, are there differences in the degree to which each can commit to life-time employment and the added identification benefits that accrue thereto?

Being (comparatively) insulated from competition in the product market, exempt from take over through the capital market, and subject to a minimal risk of termination (some bureaus shrink through attrition, but reductions in force are rare and few are closed down), the public bureau's promise of lifetime employment to its employees is especially secure. Arnold Picot and Birgitta Wolff's description of Beamtenecht employment in the German State is pertinent (1992, pp. 14-15):

The main effect of the Beamtenecht is that they are granted a life-time employment and an outstanding pension system. The state guarantees a system of promotions and lifelong maintenance payments to them, ... [in return for which] German Beamte are expected to serve their employers with a special degree of loyalty and reliability.

For example, they are not allowed to strike. The Beamten are said to have a characteristic sense of duty or even a special "ethos."

In the degree to which identification benefits are thought to be especially important, the public bureau will often enjoy the advantage in this respect.

By way of summary, public and private bureaus compare as shown in Table 2.

4. Transactions Matter Most of All

The public bureau, according to the foregoing, has little to recommend it for delivering standard goods and services--whence the hypothesis that the

public bureau is principally to be understood as a means by which to deliver nonstandard transactions. The nonstandard attributes of (1) natural monopoly, (2) sovereign transactions, (3) emergency planning, (4) quality assurance, and (5) redistribution--both in general and with respect to public bureau governance--are examined here.

4.1 natural monopoly

A natural monopoly obtains when economies of scale are very large in relation to the size of the market. Ordered in terms of decreasing incentive intensity, the four organization forms through which natural monopoly services can be supplied are unregulated natural monopoly, franchise bidding, rate of return regulation, and nationalization.

Whereas the private unregulated monopoly has the strongest incentives to keep costs under control, it will also charge whatever the market will bear--which, in the limit, are monopoly prices. By contrast, the nationalized firm has the weakest incentives and is seriously burdened by the costs of bureaucracy. Those burdens explain the conclusion that nationalization is unwarranted except in institutional environments that are unable to communicate credible commitments: "The main case for investment in public enterprises is that it is necessary to make up for the lack of private sector confidence in the future rules of the game" (Newberry, 1992, p. 3).¹⁵

Assuming, arguendo, that investors enjoy secure expectations and that monopoly pricing is unacceptable, the relevant choice is between the regulated firm and franchise bidding. As developed elsewhere (Williamson, 1976), the comparative efficacy of franchise bidding for natural monopoly varies with the characteristics of the assets and with technological and market uncertainties. Because the administrative apparatus needed to support franchise bidding converges toward regulation as the investments in question become more highly

specific and as technological and market uncertainties increase, because franchise bidding is the more highly politicized organization form, and setting redistributive purposes aside, franchise bidding is best reserved for natural monopoly services where the assets are redeployable and the technology more mature.

But how then is one to interpret organizations such as the U.S. Post Office? Or what about the Manhattan Project during World War II? Are these natural monopolies for which public ownership and operation is the least cost alternative?

The Post Office, I submit, is best examined in relation to the politics of redistribution. And the development of the atomic bomb is very special for reasons of real time responsiveness, secrecy, and security, aspects of which are examined below. Absent a special justification, of which the weak institutional environment referred to above is one, there is no general case to be made for the continuing (as opposed to ad hoc) public ownership and operation of natural monopolies.

4.2 sovereign transactions

Wilson reminds us that (1989, p. 346)

...businesses as well as governments have collected trash, swept streets, operated buses, managed hospitals, and run schools. Some of us are aware that private security firms have more employees than do municipal police departments. Americans who have traveled abroad know that in many foreign nations the governments own and operate the airline companies, telephone systems, electric utilities, and television stations, services that here are provided in large part by private enterprises. A few of us are aware that in some states businesses are running prisons. The historically-minded among us

will recall that at one time private banks issued their own money and nations going to war hired mercenary armies.

Still, some transactions are much more mundane than others. According to Paul Samuelson, "government provides certain indispensable public services without which community life would be unthinkable and which by their nature cannot be appropriately left to private enterprise," national defense, internal law and order, the administration of justice and contracts being offered as examples (Samuelson, 1964, p. 149). Relatedly, Wilson refers to "sovereign tasks" (1989, p. 359) and to the belief that "certain government undertakings are endowed with infeasible authority: There are certain commands that only the state ought to issue" (1989, p. 348).

Neither Wilson nor I provide a definition for sovereign tasks. Believing the concept to be important, however, I will describe a sovereign task as one which, if contracted out, would undermine the integrity of the state. Which tasks qualify?

Among the obvious candidates are (1) foreign affairs, (2) the judiciary, (3) management of the money supply, and (4) the military. To repeat, the issue in each case is whether contracting out for the service would seriously compromise the integrity of the state.

Foreign affairs is the most interesting of these. The difficulties of contracting out for foreign affairs can be discerned by examining this from the standpoint of (1) the franchisor (say the Secretary of State, to whom the public or private bureau reports), (2) the franchisee, and (3) the system of which the bureau is a part.

Suppose that the Secretary of State invites a franchise bidding competition. Two related problems immediately present themselves. Not only would the franchise bidding contract to manage foreign affairs be highly incomplete, but the award criterion is wholly obscure. How does a

prospective franchisee describe its capabilities? How is its performance to be assessed? What are the penalties for failure? How to deal with moles, foreign agents, treason, and the like?¹⁶ Problems of incentives, loyalty, and information impactedness are unusually acute.

In addition, moreover, to the problems as viewed by the franchisor (the government), the franchisee and its counterpart agencies in other countries also experience problems. These issues are well beyond the scope of this paper, but let me suggest two: (1) Unless franchisees are given assurance that they will not be subject to continuous oversight, control, redefinition of tasks, and the like, their net receipts are in jeopardy. Query: Can the government credibly commit not to intervene? If it cannot, then does the contract reduce to cost-plus contracting? In that event, wherein do the gains to the franchise mode reside? And if it can credibly commit, then (2) will autonomous franchisees be perceived to carry authority--in that the proposed deals and recommendations of franchisees will regularly be ratified by their governments--by the counterpart agencies of other nation-states? If ratification is assured, then who really is the government? And if ratification is especially problematic, because this is the only stage at which the government can bring its influence to bear, then what useful purpose is realized from franchise bidding? A career service in which deep knowledge of foreign affairs is acquired and extreme loyalty to the sponsor organization is expected plainly has a great deal to recommend it. Franchise bidding does not meet that prescription.

Indeed, although it was not always so (Kennan, 1993, chap. 4), every modern nation-state has its own foreign service and many foreign services have their own special employment relation (that is, do not come under Civil Service).¹⁷ The added autonomy associated with the latter can and sometimes does frustrate presidents, who think of the State Department as their

instrument for conducting foreign affairs. Albeit true in significant degree, State, more than most departments, also has a life of its own. It not only has its own voice on foreign affairs,¹⁸ but it also, within limits, has its own policy.¹⁹

It is easier to imagine that the judicial function could be contracted out--which, in significant measure, it is. The earlier discussion of private ordering (as compared with legal centralism) speaks to the efficacy with which private parties can order their own affairs. It is nonetheless important for courts to be available for purposes of ultimate appeal (Llewellyn, 1931). The knowledge that contracts can ultimately be appealed to the courts serves to delimit threat positions and thereby infuses integrity into the contracting process.

The question then is whether ultimate appeal could also be contracted out. That poses deeper issues of veridicality and is examined in relation to this criterion in 4.3, below.

The management of the money supply is one that modern states have also internalized, although it is sometimes argued that this could be and should be contracted out. Compromise forms of organization--such as the Federal Reserve--which enjoy semi-autonomy and listen to the voices of both Pennsylvania Avenue politics and Wall Street finance reflect the tensions. A detailed development would be useful but is beyond the scope of this paper.

Consider finally the military. It may be essential in this connection to distinguish between the strategic decision making function in the military, which is arguably assigned to a career staff (again a special employment relation) subject to civilian control, and the operating part. Might the latter be organized as mercenaries? What are the limits of an all-volunteer army? The issues have been discussed elsewhere by others (Demsetz, 1967;

Tobin, 1970). Suffice it to observe here that the notion of military service as a nonnegotiable obligation is strongest during wartime, when it becomes a matter of distributing the risks of death and injury (Tobin, 1970, p. 269).

4.3 emergency planning

Ely Devons observed of wartime planning by the Ministry of Aircraft Production in England during World War II that (1950, p. 2):

It was always assumed without question in M.A.P. that this planning was necessary, and that without it aircraft production would have suffered. There were indeed skeptics who asserted that aircraft were produced in spite of, rather than because of, M.A.P.'s planning. But such critics never seriously suggested that M.A.P. should give up its attempts at planning; they thought that the methods and techniques used could be substantially improved. Because of this unquestioned acceptance of the need to plan aircraft production, rather than operate through a competitive price system, no one in M.A.P. ever tried to explain why such planning was necessary...[in terms] of some general theory of war-time economic planning. To the officials concerned, M.A.P.'s planning activities were forced on them by the logic of events.

Among the reasons for this takeover of planning by the government was that the government was unable to disclose the relevant information (Devons, 1950, p. 4):

[I]t was most unlikely that business men would have been willing to invest in capacity for the production of munitions..., for they had no basis on which to assess the likely length of the war.... The government alone possessed this knowledge, and therefore had to

assume the risks in choosing one line of investment rather than another.

I submit, however, that better knowledge by the government--either as to the length of the war or as to how this varied as a function of the resources applied to winning the war--pales in relation to the really salient feature, which is that time was of the essence: unless coordinated investment and production decisions were made in a timely way, the war would be lost. All of the problems of nonconvergent expectations--divergent views, maladaptations, delays--referred to by Harold Malmgren (1961) in his examination of vertical integration were compounded by the war.

Thus the principal problem with the market was not that investment risks were prohibitive but that risks of delay were unacceptable. Real time responsiveness to emergencies differs in kind from real time responsiveness to changes in demand or supply of the sort to which Hayek (1945, pp. 524-527) referred.

Specifically, whereas Hayek was concerned with transactions for which prices served as sufficient statistics, which benefitted from high-powered incentives and low bureaucratic costs, and for which convergent expectations were not implicated, wartime emergencies involve interdependent transactions for which high-powered incentives can get in the way and for which responsiveness trumps bureaucratic costs.

That high-powered incentives can get in the way is because these can elicit false and misleading moves, preemptive investments, posturing, disputes, and the like. Government bureaucrats to whom planning responsibilities were assigned experienced lower-powered incentives because they were removed from direct participation in the differential net receipts of the firms whose investment and production coordination was being attempted. Also the wartime contracts between the government and the firms were commonly

of a cost-plus variety. Although both planning and cost-plus contracting come at a cost, the bureaucratic costs of planning and the wastes associated with cost-plus contracting were arguably acceptable in the context of a wartime crisis.

More generally, I submit that the real-time emergencies of all kinds are ones for which nonmarket organization arises (Williamson, 1993a). To describe wartime planning as a "paradox" is therefore unwarranted. Recourse to low-powered incentives and hands-on coordination is exactly the recipe for emergency responsiveness. The surprise is that the market solution has such a grip on social scientists that all deviations are described as paradoxical or unnatural. An instrumental assessment of the strengths and weaknesses of alternative modes is needed instead.

4.4 quality assurance

Interestingly, the question of quality assurance has been treated extensively in the private ordering literature (see especially Benjamin Klein and Keith Leffler (1981)). The efficacy of private ordering for quality assurance respects varies, however, with the market context. Contracts between firms--intermediate product market transactions--are ones for which efforts to relieve information asymmetries and infuse confidence, by creating credible commitments, often work well. Providing quality assurance to consumers of final goods and services, especially the latter, can be more problematic. Labor market transactions are located in between.

(a) intermediate product markets

Information impactedness refers to a condition of information asymmetry that is very costly to relieve or redress in the context of unassisted private ordering (Williamson, 1975, pp. 31-37). The caveat is important, since virtually all transactions involve information asymmetry in some degree. In

the context of intermediate product market transactions, however, it is often easy and/or cost effective for the less informed party to gain information parity and/or to provide contractual safeguards that mitigate the hazard.

Assume, for example, that the buyer of an intermediate good or service is the less well-informed party. It can close the gap by hiring a variety of specialists--e.g., lawyers (to negotiate the deal), purchasing agents (who are knowledgeable about transactions of this kind), and engineers (to run qualification tests on delivered product and, possibly, to conduct on-site inspections of the supplier's plant). Also, the buyer can use these same specialists to seek redress where that is indicated (including the credible threat of a lawsuit). Furthermore, a whole series of transaction-specific governance safeguards can be introduced as well: penalty clauses can be introduced into the contract, provision can be made for nuanced information disclosure if and as needed, and specialized dispute settlement mechanisms (such as arbitration) can be devised. Finally, a well-working reputation effect mechanism (in which both own-experience and the experience of others in the industry is taken into account) serves further to infuse integrity into trade (Kreps, 1990).

To be sure, private ordering in intermediate product markets is better able to tune up bilateral than multilateral transactions. Network externalities (Katz and Shapiro, 1986) and third party spillover effects (positive or negative externalities) are candidate transactions where the public bureau can beneficially assist in the management of intermediate product markets.

The public bureau brings value added to these intermediate product market transactions not because it enjoys an information advantage in relation to the parties. Rather, what the bureau brings is a relatively disinterested party that can (sometimes) act more knowledgeably and expeditiously than can the

courts. Given that the parties have difficulties contracting across the externalities in question (which difficulties are jointly the product of bounded rationality and opportunism and sometimes take the form of holdouts), engaging a disinterested but informed party to which enforcement and fiat powers are assigned (including, possibly, the credible threat to seek legislation in the event of an impasse) has a good deal to recommend it. A public bureau might therefore be created to fulfill those functions.

(b) consumers and nonprofits

Contrast these intermediate product market supports with those of an individual consumer purchasing a product with carcinogenic effects (tobacco; benzene), or a drug (AZT), or food additives, or auto safety options. Or consider the efforts of individual workers to assess and contract intelligently with respect to job safety.

Many final consumer and some labor market transactions are characterized by (comparatively) shallow knowledge, confusion, inability to craft a specialized governance structure, weak reputation effects, and costly legal processes. Although groups of consumers could and sometimes do create their own specialized agents to contract on their behalf, there are serious collective action problems in forming such groups and in excluding free-riders (Arrow, 1969). Unlike firms, moreover, consumers are rarely able to integrate backward--thereby to relieve the troublesome transaction by placing it under unified ownership.

To be sure, the providers of hard to measure goods and services sometimes can and do create added safeguards through branding, warranties, authorized service, and the like. Whether best private efforts of buyers and suppliers to concentrate the costs and benefits can be improved upon with net gains (remediableness) is the question. Transactions where the buyer presents the supplier with an idiosyncratic condition--for example, his physical or mental

health--for which judgment is required can be especially difficult to safeguard under purely private auspices. Also, transactions where the immediate beneficiary may be poorly qualified to judge quality variation, such as the very young (as in schooling) or the very old (as in nursing homes), pose special difficulties.

The nonprofit form of organization arises in support of some of those transactions for which quality assurance is especially problematic. The issues are frequently discussed under the rubric of "trust goods"--which are those for which buyers "suspect that for-profit firms will deceive them about the quantity or quality in order to enhance profit. Thus, for trust goods, demand exists for a different organizational form, one for which profit is not the dominant motive" (Ben-Ner and van Hoomissen 1991, p. 527).

Because pecuniary incentives in the nonprofit are less pronounced, the nonprofit supplier is purportedly less given to opportunism in quality shading respects. Note, however, that the nonprofit experiences a special financial disability: it is unable to raise equity capital. That is because the nondistribution constraint is a defining characteristic of the nonprofit form of organization (Hansmann, 1980) whereas a defining characteristics of equity are that it is a residual claimant and is invested for the life of the firm. These two collide. Thus although nonprofits can and do use debt finance--because the obligations to pay interest and principal are well defined--they cannot raise equity.

As developed elsewhere (Williamson, 1988), some private, for-profit firms can be and ought to be financed predominantly by debt. Specifically, if the assets needed to produce a good or service are mainly generic then debt finance is appropriate. If, however, the assets are nonredeployable then greater discretion (relief from the unforgiving rule governance associated with debt finance) is needed. Equity is a much more discretionary form of

finance, but that added discretion comes in exchange for control and residual claimancy. The ramification for nonprofits is that goods and services that are supported by substantial investments in durable, transaction specific assets are poor candidates (which is to say that those that are supported by generic investments are better candidates) for the nonprofit form.

Projects for which nonprofits are poorly suited because nonredeployable assets cannot be financed except on prohibitive terms can sometimes be undertaken by public bureaus to which public monies are assigned. Within the universe of projects for which added veridicality (over and above that which obtains naturally under private ordering) is important, the public bureau will therefore organize those for which asset specificity is especially great.²⁰

4.5 redistribution

The U.S. sugar program has been described by George Stigler as follows (1992, p. 459):

The United States wastes (in ordinary language) perhaps \$3 billion per year producing sugar and sugar substitutes at a price two to three times the cost of importing the sugar. Yet that is the tested way in which the domestic sugar-beet, cane, and high-fructose-corn producers can increase their incomes by perhaps a quarter of the \$3 billion--the other three quarters being deadweight loss. The deadweight loss is the margin by which the domestic costs of sugar production exceed import prices.

How are programs such as this to be assessed?

A common interpretation is that the deadweight loss represents inefficiency: "The Posnerian theory would say that the sugar program is grotesquely inefficient because it fails to maximize national income"

(Stigler, 1992, p. 459). The fact that the sugar program has statute-based, rather than common law-based, origins is, purportedly, a contributing factor.

Stigler takes exception with efficiency of law scholarship both in general (the statute-based versus common law-based distinction) and in his interpretation of the sugar program. The problem with the argument that the common law is efficient while statute law is problematic (Landes and Posner, 1977) is that it rests on an underdeveloped logic (Stigler, 1992, pp. 459-461). More pertinent for my purposes is Stigler's argument that "Maximum national income...is not the only goal of our nation as judged by policies adopted by our government--and government's goals as revealed by actual practice are more authoritative than those pronounced by professors of law or economics" (Stigler, 1992, p. 459).

Rather than appeal to deadweight losses in relation to a hypothetical ideal, Stigler proposes that the appropriate criterion is the test of time, according to which criterion he declares that the "sugar program is efficient. This program is more than fifty years old--it has met the test of time" (Stigler, 1992, p. 459).

In effect, the test of time is a rough-and-ready way to assess remediableness--the assumption being that if there were a cheaper, feasible, and implementable alternative then it would be implemented. That test makes no provision for organizational breakdowns, however, and it assumes that the democratic process has been and is working acceptably. I address these issues elsewhere, where, after making allowance for egregious intertemporal breakdowns of organization and/or politics, the Stiglerian test of time criterion is reformulated as a rebuttable presumption (Williamson, 1993b).

Note in this connection that politics is different not merely because votes are unit weighted by individuals (one-person one-vote) rather than by shares (one-share one-vote) but also because "the driving force of politics is

rooted in the coercive power of public authority" (Moe and Caldwell, 1993, p. 4). There are winners and losers, and winners are expected to approve and implement programs that favor their constituencies. Public bureaus are instruments through which many such goods and services are delivered.

John Donahue's examination of local service contracting is pertinent. Thus Donahue reports that median savings of 42 percent could be realized from the contracting out of eight public services, approximately a quarter of which savings are explained by lower wages and benefits in the private sector (Donahue, 1989, pp. 139, 145). But Donahue, like Stigler, is also unwilling to describe this as a condition of inefficiency. Productivity losses notwithstanding, "Government work offers job security and employee rights that are uncommon in the private sector. To insist that nothing matters in public service delivery but the raw dollar cost is to adopt a needlessly narrow view of government" (Donahue, 1989, p. 145).

5. Concluding Remarks

Bureaucracy is a familiar condition: we are confronted (some would say assaulted) by bureaucracy at every turn. Yet it is a poorly understood condition and has become a "term of scorn the world over" (Robinson, 1991, p. 5). Strange--both in general and as compared with the attitude toward markets. How is it that an organizational form on which we so much depend is regarded with disdain--being justified, like taxes, as "the price we pay for civilization" (Robinson, 1991, p. 5)? Markets, by contrast, are described as being a "marvel".²¹ Why the difference?

Part of the difference is that markets are more anonymous and spontaneous forms of organization. Being more intentional, bureaucracies are expected to behave in reasoning ways--which, views to the contrary notwithstanding, they often do. But bureaucracies are heavily rule-bound and often behave in

unfeeling, mechanical, even arbitrary and dysfunctional ways. Furthermore, both bureaus and bureaucrats are entrenched and are asked to serve variegated and sometimes conflicting purposes.

An instrumental view of bureaucracy is herein advanced, according to which public and private bureaus are simply alternative modes of governance.²² Because every generic mode of governance possesses distinctive strengths, all deserve respect. Because each also possesses distinctive limitations, none deserves unqualified or undue respect. One of the purposes of social science is to discover the distinguishing attributes of each generic mode of governance, thereafter to align public and private bureaus with transactions in a discriminating way.

The core arguments of the paper are these:

- (1) All governance structures, of which the public bureau is one, are defined by a distinctive syndrome of attributes. These are indwelling features and explain why alternative modes of governance differ in discrete structural ways. As compared with private bureaus, public bureaus are characterized by very low powered incentives and carry larger bureaucratic cost burdens.
- (2) The very low powered incentives and added bureaucratic costs to which the public bureau is subject are explained by the fact that the public bureau is a creature of politics and is embedded in politics and because the contract law of bureaus (Civil Service law in combination with administrative law) elicit these properties.

- (3) Although the very weak incentives to which the public bureau is subject disadvantage public bureaus in relation to private bureaus for the management of most transactions, there are some transactions that benefit from very low powered incentives and the added veridical supports that (sometimes) accrue thereto. The challenge then is to ascertain what these special transactions are and why the properties of the public bureau cannot be replicated by private bureaus.
- (4) It is frequently argued that the tasks that are undertaken by a public bureau should be contracted out. Assessing this is a tripart exercise in which the efficacy of contracting out is examined from the standpoint of (1) the franchisor (in this case, the government), (2) the franchisee (the outside contractor), and (3) the system within which the contractual relation is to be embedded. Serious problems at any or all three of these stages may disqualify outside contracting.
- (5) Contrary to earlier treatments which emphasize the commonalities of "formal organizations" and maintain that public and private bureaus differ negligibly in performance respects (Simon, Smithburg, and Thompson, 1950, p. 8; March and Simon, 1958; Simon, 1991, p. 38), this paper focuses on the differences between public and private bureaus and maintains that these have significant performance consequences.²³ Upon making allowance for these differences, public bureaus are brought within the ambit of the discriminating alignment hypothesis out of which transaction cost economics works.

- (6) Since all feasible forms of organization are "flawed," it is easy to show that any actual form of organization compares unfavorably with a hypothetical ideal. That, however, is operationally irrelevant. The relevant test is that of remedialness--according to which an organizational form is efficient if no feasible alternative can be implemented with expected net gains.

Footnotes

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1. But for minor exceptions, this paper simplifies by dealing only with public and private bureaucracy in the United States. Extension of the argument to attempt international comparisons of public and private bureaus must await a fuller development of the pertinent differences in the institutional environments within each of the nation states across which comparisons are attempted.
2. As Rachel McCulloch observes, both "traditional and newer IO-based models" of trade assume that "unintended redistribution can be reversed costlessly through ideal lump-sum transfers and that required government funding can be obtained costlessly through ideal lump-sum taxes" (1993, p. 370). The economics of costless, lump-sum correctives is a heroic simplification.
3. Franchise bidding for natural monopoly is one example (compare Posner (1972) with Williamson (1976)). The path dependency literature comes perilously close to and sometimes steps over the edge (Williamson, 1993b). Those "efficiency of the law" arguments with which George Stigler (1992) has taken exception are likewise deficient in remediableness respects.
4. This is pertinent to 1.1, above. Also note that there is a tradeoff: unified political systems, such as parliamentary regimes, have a lesser need for compromise but have weak political property rights; fragmented systems, such as separation of powers regimes, have a greater need for compromise but, because of inertia, communicate stronger commitments (Moe and Caldwell, 1993). The analysis of economic organization needs to come to terms with these discrete structural properties.
5. Many goods and services are hard to measure, but only a few are concurrently provided by all three forms. Especially in intermediate product markets, measurement difficulties elicit what are often efficacious private ordering responses (see 4.4, below).
6. Avner Ben-Ner and Theresa van Hoomissen report that 100 percent of the employment in mining, construction, and manufacturing in New York State in 1987 was accounted for by for-profit firms, and 99 percent of personal and business services, agriculture, communications, and electricity, gas, and sanitation was also organized in private firms (1991, p. 546).

7. Unintended consequences are sometimes pertinent. Franchise laws, for example, that have protectionist purposes can have the (unintended) effect of discouraging franchising, with net negative efficiency consequences (Klein, 1980).
8. Not only are bonuses rare and small, but "employees and managers, though they sometimes approve of merit pay in principle, tend to dislike it in practice" (Wilson, 1989, p. 144).
9. Note, however, that the argument is not strictly comparative. The OSHA inspectors and the insurance inspectors have different tasks.
10. Note that (1) fragmentation can also have credibility benefits (see 3.2, above) and (2) fragmentation is more prevalent at the federal and state than local levels.
11. Private sector organization is also the product of compromise. Egregious inefficiency in the private sector is checked, however, by competition in both product and capital markets. Note with reference to the latter that the voting rules in the private and public sectors are very different. The private rule is one-share one-vote, and shares may be concentrated through purchase. The public rule is one-person one-vote, and the "purchase" of votes is much more cumbersome. Because, moreover, the gains that result from improved efficiency accrue (in the first instance, at least) to private sector owners in proportion to their ownership, private incentives to concentrate ownership and remove inefficiency are greater.
12. To be sure, the federal government is a series of semi-autonomous and very different departments rather than a unified hierarchy. Moreover, some departments do not operate under the Civil Service--the career foreign service being an example, where the Rogers Act of 1924 defined a career diplomatic service that would be "semi-independent" of both the State Department and of the Civil Service system (Wilson, 1989, p. 94). Like divisionalized firms, however, where differentiated compensation and terms of employment are difficult to sustain (Williamson, 1985, chap. 6)--which is one of the reasons why Japanese firms engage so extensively in subcontracting, government is mainly regarded as a composite employer, within which uniform employment rules will be observed.
13. Koopman's has reference not to economizing but to profit maximization, which is a related but more encompassing concept.
14. The proverbial "dog catcher" is an exception, as is the district attorney and some state attorneys general.
15. To be sure, nationalization could be favored as a means of redistributing income--either to corrupt administrators or to labor (through wage premia). That, however, is another matter. Those purposes aside, the efficiency case for nationalization is as reported above: as a response to the hazards of expropriation posed by a polity that is unable to communicate credibility.
16. It is not accidental that there is a special language for describing deceit in foreign affairs.
17. See note 12, supra.

18. The candid statement of the "third ranking" official in the State Department Department--initially speaking anonymously to the press--on the "effective" foreign policy of the United States with reference to Bosnia contradicted the public posture of the Secretary of State (Warren Christopher) and President Clinton when those views were first expressed in May 1993. As of August 1993, four career foreign service officers have resigned in protest over this policy.
19. President Truman complained to his Secretary of State, Dean Acheson, that the career staff at State were not sufficiently obedient (McCullough, 1993). Acheson responded that the career staff were good people and loyal. What he did not say was that their loyalty was partly to the system rather entirely than to the president.
20. A careful comparison of nonprofits and public bureaus is beyond the scope of this paper. I submit, however, that government bureaus have weaker incentives, are better able to finance projects that require nonredeployable investments, and have advantages for delivering uniform (as opposed to differentiated) benefits.
21. Friedrich Hayek referred to the market as a "marvel" so as to "shock the reader out of the complacency with which we often take the working of this mechanism for granted" (1945, p. 527).
22. Jean Tirole (1993) similarly adopts an instrumental view. But he examines bureaucracy mainly from the standpoint of incentive theory whereas I emphasize transaction cost economics. The two are mainly complementary.
23. Gary Walmsley and Mayer Zald (1973, p. 15) and Tirole (1993, p. 1) proceed similarly.

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Governance Attribute	Governance Structure		
	market	hybrid	hierarchy
instruments			
incentive intensity	++	+	0
administrative controls	0	+	++
performance			
autonomous adaptation	++	+	0
cooperative adaptation	0	+	++
contract law (reliance on legal rules)	++	+	0

Table 1

Private Sector Governance

0 : denotes weak
 + : denotes semi-strong
 ++: denotes strong

Governance Attribute	Bureau Type	
	Private	Public
instruments		
incentive intensity	low-powered	very low-powered
administrative controls	great	greater
performance		
autonomous adaptation	weak	weaker
cooperative adaptation	good	good but slow ¹
integrity	some	much ²
contract law	forbearance	Civil Service plus administrative law

Table 2
Public and Private Governance

¹exception: emergency preparedness (see Section 4.3).

²caveat: mainly has reference to "sovereign transactions" (see Section 4.1).