El reto economico de abrir la caja negra de la toma de decisiones politicas

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PREFACE

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PREFACE

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This book is about the central issue of multi-level economic policy-making in democratic societies. It is a central issue because at a time when several "wealthy countries" are facing a major crisis, we need to understand why economic policies have such a hard time addressing market failures. In that respect, the following chapters provide a very refreshing and relevant discussion of the issues at stake. They do so with a view at the complexity of the problems our economies face. Indeed, they all share the conviction that there is not such a thing as 'one fits all' policy, that public interventions are deeply embedded in an institutional environment, and that solutions must be assessed in a comparative way, with no optimal response to the major difficulties we have to deal with.

Not that many economists are ready to embark on this exploration of the new world we are entering. It is quite amazing how little our way of thinking about policy issues has changed through the ongoing crisis. In most economic analyses, institutions do not exist, so that the same recipe would have the same value and relevance everywhere. If institutions are mentioned, it is as a black box within which policies are designed and decisions are made without due consideration to the impact of, say, the voting system on how and what economic choices are made. This book also brings in some fresh air in that respect. It provides contextual analysis in which institutional singularities of the political decision-making arena are taken into account. Mostly coming from applied economics and politics departments, the contributors are fully aware that we have to deal with collective decision-making problems that require, as rightly pointed out by Ronal Coase in his Nobel lecture (Coase, 1992, p. 178), a combination of sound theory and field research, with a view at the puzzles and anomalies characterizing the interactions of agents embedded in firms, markets, administration.

This is to say that the rich approaches proposed in this book are in line with the *political economy* tradition, far away from blackboard economics. Out of the beaten path according to which we should 'put aside the inherently misleading governmental actions and let markets operate the required changes', which means ignoring how deeply markets are nested in institutions, there are two alternative ways to look at public policies. One is rooted in agency theory: public policies involve multi-layers, multi-principals problems that should be solved through building adequate incentive mechanisms so that actors will behave according to the goals defined through democratic mechanisms. In that perspective, there is not much room left for the economic analysis of the institutional background, a task 'delegated' to political scientists, at risk of throwing out of economic representations the impact of institutions. The other approach stands on the concepts provided by new institutional economics. The starting point is that there are political as well as economic transaction costs involved in policy-making, so that institutions should not only be incorporated as explanatory variables, but also be considered as endogenous to the policy-making process itself, at work at the different levels of government and impacting the production and allocation of resources

as well as the distribution of income and property rights, all of which must be assessed in a comparative way.

Political Transaction costs.

The red thread unifying most analyses in this book comes out of this second strategy, with a particular attention to the distributive impact of institutional arrangements**.** [1] Through their diversity all chapters focus on the explanatory dimension rather than on normative prescriptions. It is a deliberate choice, following the editors' recommendation and calling attention to the fact that policy analysts as well as policy-makers so often disagree about which policies could be well-being enhancing. It is so not only because policy-makers are limited by their bounded rationality and guided by diverging or even conflicting interests and goals, deeply rooted in beliefs and norms. It is also coming out of what Douglass North identified as high 'political transaction costs,' a dimension that makes things even more complex. Let me focus on this aspect, which relates more to my own research in industrial organization and on the variety of business organizations, particularly firms and hybrids.

The concept of transaction costs is familiar to economists. It designates the costs of organizing transfer of rights to use goods and services among economic entities (individuals, firms, networks, etc.) operating within technologies that determine which activities can be separated. Typical is the transfer of property rights, of course. As soon as a technology allows separation, the issue becomes: how to organize these transfers and what are the related costs? The extension of the concept to the polity comes out of the idea that political regimes also organize transfer of rights, but rights of a different nature: redistributing rights among groups of interest, allocating or reallocating rights to vote, negotiating budgets, etc., all of which involve costs (e.g., costs of political bargaining, of reaching a solution through coalition building, and of enforcing decisions made). All these transfers among political constituencies require supports that define a political regime and that play in policy-making a role analogous to the one played by the transfer of property rights through different modes for organization. A direct consequence is that different political regimes entail different political transaction costs, so that there are trade-offs among alternative institutional frameworks.

New institutional economists and social scientists have developed these two concepts, the concept of economic transaction costs and the concept of political transaction costs, which are defining two different and complementary branches of their research agenda. One concerns institutions broadly defined, e.g., the political regime, the judiciary, laws regulating markets, etc., thus referring to the general rules that determine the characteristics of the institutional environment and endowments. These formal rules, but also informal ones rooted in culture, traditions beliefs, frame and constrain the behavior and domain of action of all entities, individuals, policy-makers, public as well as private organizations (Davis and North, 1971: 6 sq.). The other relates to how agents organize their actions within these institutions, it focuses on players, their behavior, their organizational choices (e.g., using the market mechanisms, integrating within a firm, providing services through public bureaus or independent agencies, etc.).

Although these two branches differ by their domain, they are congruent through the fundamental concepts they share: transactions, contracts, property rights, defining the so-called 'golden triangle' of new institutional economics (Furubotn and Richter, 2005), that provide an important part of the background of numerous contributions in this book. Without getting into the details, let me emphasize very briefly some key aspects of these concepts that, in my view, are essential for understanding the purpose and deliveries of the coming contributions. (1) Transactions are considered central by new institutional economists because what an economy does is not primarily

[1] See for example Libecap 1989; Knight 1992; Knight and North 1997; Williamson 1996; Toboso 2011.

the transfer of physical objects or virtual services, but rather the transfer of RIGHTS to use these resources. This can be done through private sector organizations such as markets, firms, franchising systems, etc., but also through political transfers (e.g., taxation, public organizations, or hybrid solutions such as public-private partnerships. (2) There are many different types of rights, beside property rights, which can be transferred either through the economic regime or through the political regime, an issue well illustrated by the rich contributions of Ostrom (chap. 14 of this +). Economic policies can be understood as a way to allocate and redistribute a significant chunk of these rights among participants to the social fabric. (3) Contracts are specific mechanisms for transferring rights, of particular significance for economists and maybe a little less so for political scientists or legal scholars. In markets economies, with decentralized decision-makers, as well as in democratic regimes, with competing political parties, transfer of rights must be based on forms of mutual consent that contracts formalize. The social contract that provides the foundations of our societies and that is challenged by the ongoing crisis illustrates well how incomplete (and potentially fragile) contracts are. This is why institutions such as the judiciary are necessary.

Sources of Political Transaction Costs.

Beside many other aspects, this book provides interesting insights about the sources of these political transaction costs. Let me emphasize three of these sources.

First, the structure of the political system itself generates costs. Because all political systems involve multiple layers in decision-making, the definition and implementation of policies face multiple principals' problems, that is: the delicate equilibrium among different centers of power, the significance of which varies across countries, depending among other things on the degree of decentralization. For example, voters may elect a political party at one level of government and its opposition at the other level. This multiple layers' problem can be even more complicated if different voting rules apply at different levels of government. To illustrate, senators can be elected along rules than differ from those prevailing for the House of Representative (the US model), or can be appointed by the government (the British model). This makes political transactions and their costs very different, of course.

Second, democratic regimes are characterized by the existence of rival political parties as well as different groups of interest. Each has its own strategy and agenda, so that decision-making is a complex process of coalition building. For historical as well as cultural reasons, some countries have parties more prone to coalition building while others have a more confrontational tradition. The same can be observed with groups of interest prone to what has been called 'third party opportunism': unions, environmentalists, religious groups, etc. lobby to have their agenda prevailing over that of duly elected representatives. This might well make coalition building among political parties submitted to these 'influence' much more complex, as so well illustrated by the radicalization of the Republican Party under the influence of the so-called 'Tea Party' in the US, the result being a peak in political transaction costs.

Third, there is the credible commitment issue. Economic policies take time to be defined and implemented. However, political cycles are disconnected from business cycles, making it difficult for policy-makers, even if well-intentioned, to adopt and stick to policies that may be perfectly sounded but potentially conflicting with the political cycle. Building credible commitment with respect to economic policies is a long shot game that does not go easily with the requirements of political life. This raises a fundamental trade-off: representatives need legitimacy, which they obtain through repeated elections, while efficient economic policies may impose long term decisions that need not be easily rescinded if they are to be credible.

These sources of political transaction costs cover only parts of the spectrum of factors identified in the different chapters of this book. In refereeing to these specific components, I only intended to point out the significance of the costs at stake and the urgent necessity to take them into account when examining alternative policies.

Impact of Political Transaction Costs.

Organization theory has now well-established that transaction costs play a central role in the choice of a specific mode of organizing transactions (e.g., using the market mechanisms to acquire an input, making it in-house, or obtaining it through a network[2]) and in the comparative performance of these alternative arrangements. It can be argued, and several chapters of this book provide substance to this view, that there is analogous trade-offs among institutional regimes, with political transaction costs playing a crucial role in the resulting choices. Changing the rules of the game, even a small subsets of these rules, is a complex and costly process: think about changing the filibuster rules that tend to paralyze the US Senate; or changing the regulation of the labor market; or implementing democracy in Afghanistan! As well-illustrated in several chapters in the book, it is so because democratic processes are very complex, political markets highly imperfect, and collective choices often related to highly sensitive issues, with protagonists promoting interests and views that often conflict.

First, changing rules involve the coordination of different layers of government. This coordination problem underlies the old but still vivid debate about the virtues and flaws of federalism vs. unitized political regimes. As several contributions show, there are agents or groups of agents that may attempt to implement institutional changes, particularly in situation of crisis. But beside the coordination problem that condition the efficiency of their action, there is also a problem of consistency, with some constituencies fighting to implement changes in specific arenas or territories and opposing similar changes in other territories or political arenas. As North (1990, p. 16) and others have emphasized, there is even the possibility that some parties adopt and enforce new rules that protect their vested interests by increasing transaction costs for others! Estimating collateral costs through comparative analysis should be a must for policy-makers. It is amazing how little has been done in that respect, and this book, with several other contributions,[3] is a call to young researchers to engage in this direction, which is the only way to get rid of decisions based only on ideologies.

Second and partially related to the previous question is the issue of the respective costs and benefits of delegation, e.g., transferring decision-making to regulatory agencies. Delegation can be about rules, e.g., translating general rules into specific ones at the local, regional, or even national level, as with the principle of subsidiarity in the European Union, or with the transfer of implementation of competition rules to competition authorities. Delegation can also be about content, as when regional states or provincial governments have the capacity to implement different economic policies, which may open room for experiences that push the economy uphill, as it has been argued to explain the Chinese growth, or the Canadian stability through the recent financial crisis. However, delegation can also challenge the credibility of political commitments (a problem pointed out about the Argentinian decline over the last century). Again there are political transaction costs involved in delegating as well as in not delegating, which need to be assessed empirically.

[2] Williamson (1996, chap. 4) provides a model; Ménard and Shirley (2005/2008) and Ménard (2013) provide empirical surveys.
[3] Numerous contributions are collected in Ménard and Shirley (2005/2008) and Ménard and Ghertman (2009). From a very different point of view, see also Ostrom (2005).

Third, political transaction costs have a strong impact on the trade-off among alternative modes of organizing the implementation of public policies, e.g., through public administration or agencies, which is also an issue discussed in this book. The question of the adequacy between policies adopted and their actual implementation is nowadays captured through the popular concept of 'governance'. Governance concerns the choice of organizational arrangements (1) to define actions to be undertaken with respect to certain goals; (2) to allocate among the different levels of public authorities the capacity to make decisions, with expectations that only specific allocations would be adapted to these goals, and (iii) to establish and implement accountability which, in a democracy, is the foundation of legitimacy. 'Good' governance is therefore the capacity for public administrations to align outcomes with goals defined by policy-makers. It is a critical step in delivering policies expected to be in the interest of the majority of citizens, mitigating their problems and enhancing their well-being. However, bureaucratic opportunism, which means that specific bureaucratic interests diverge from the general goals, is a well-known phenomenon (see already Niskanen 1968). This discrepancy pushed political transaction costs upwards and can reach the point where it challenges the legitimacy and credibility of policy-makers.

In sum, political transaction costs can be the source of government failures, parallel to the market failures coming out of economic transaction costs. When decision process or conditions of implementation push these costs upwards, the organization of a democratic regime is increasingly perceived as not suitable for promoting the interest of the majority and meeting its expectations. Identifying the sources of these government failures provide indispensable insights to explain the bumpy road followed by almost all economic policies since the world financial crash. Putting the analysis and evaluation of these elements high on the research agenda, as suggested in this book, should therefore be a priority for researchers and policy-makers.

Some concluding remarks.

Beyond the issues of the appropriateness of public policies to the needs of citizens and of the capacity and motivation of the public administration to implement more or less adequately these policies, there is a more general problem, which relates to institutional design. When analyzing the implementation of reforms in the delivery of essential services, or the means needed to fight corruption coming out of how political parties are financed, or the changes necessary to make financial systems less speculation-oriented, we should not focus exclusively on, and blame solely, politicians or bureaucrats. We must also take into account the layer that links general rules of the game, as established through the political or judicial regime, and the domain of actions these rules delineate for economic agents.

I have elsewhere suggested to identify this intermediate layer as the domain of 'micro-institutions' (Ménard, 2009: 40 sq.; de Mariz et al., 2014). By micro-institutions I mean organizational arrangements in charge of actually translating and implementing rules established at the institutional level, thus framing the actual activities of operating entities. Indeed, implementing public policies can be done through many different channels, as illustrated in several chapters of this book. It can be done through 'command-and-control', as when a public bureau is in charge of that implementation; through contractual arrangements between public authorities and private operators, with Procurement Regulatory Authorities supervising compliance with rules and regulations; through specialized regulators monitoring different infrastructures, as in electricity or railways; through competition authorities responsible for disciplining parties so as to make markets efficient; etc. All these 'micro-institutions' play a key role in framing economic and social policies and determining their actual impact on the society. This is a wide and relatively unknown territory, and scholars with a political economy fiber, such as the contributors to this book, are in a particularly good position, with adequate conceptual equipment, to explore this territory.

Another important aspect that requires further investigation is the role of 'informal' institutions (norms, social values) that often prevail over formal rules. It is very promising to see these issues often taken on board in this book, for example in the chapters about how social policies such as pension plans or health care systems have an impact on growth (which is good to read in these times of social policies deconstruction), or in the chapter by Ostrom about collective action. Almost totally absent from the mainstream neoclassical literature, which is a very 'narrow' discipline in that respect, these considerations about 'informal' institutions are gaining increasing attention in institutionally oriented analyses, and it is good to find them in this book. Let's hope that more and more researchers will catch up on this front as well.[4]

To do so they will need, we all need, to open economics to other disciplines. This is a trademark of new institutional economics, as well as some other traditions in economics and political economy, and it is very positive to have this openness in this book. There is indeed a propensity among economists to transfer the problems at stake, for example the impact of voting rules on the definition and implementation of economic policies or the role of lobbies in the design of regulation, to sociologists or political scientists. As stressed in several chapters, to better understand and appropriately reform the financial system, monetary policies, taxation, or to improve national accounts so as to make available statistics on the type of costs described above (political as well as economic transaction costs), we need to open doors to other disciplines. In doing so we should not lose the benefits of mainstream economics, notwithstanding the need to revise many of their basic concepts and assumptions, as pointed out in several chapters. We must target specific aspects of a general problem so as to be able to capture them through adequate concepts and to be able to develop models and collect data, which are necessary (but not sufficient) conditions to make the analysis operational as Coase emphasized long ago. We all have to push further to make this happen on a larger scale.

Let me wrap up this long preface by emphasizing the important points made by Eggertson (chap. 13), which is that understanding economic policies required 'knowledge intensive activities' and by Ostrom (chap. 14) about the highly complex issues at stake, which require getting into the details that only field analysis can provide. Institutions, particularly informal ones, are heavily value-loaded and evolve slowly over time. Economic policies adopted through majority voting procedures at different tiers of government, which is a central characteristic of democratic regimes, are deeply influenced by the singular institutions of each country. Scholars wanting to understand the logic of these policies must take this situational, contextualization aspect on board (and even more so if they intend to make recommendations and influence policy-makers). As stressed along this book and by Ostrom in the final chapter, we must get rid of the technocratic views about the 'one fits all' approach to economic policies. We must all become fully aware, as the contributors to this book are, that alternative solutions always exist, and that choices must be based on comparatively assessing these alternatives, which needs careful investigation, particularly since public policies almost often involve important and unexpected distributional consequences. We must be grateful to the editors of this book for having initiated a project that contributes so nicely to this goal.

[4] There is another issue that deserves mention, which is the important role of incentive mechanisms that contribute so much to the success or failure of specific policies and that raise so many problems when it comes to the efficiency of public bureaus and organizations. In that respect, there is a lot to learn from agency theory. It would be nice for future editions of this book to include chapter(s) in this direction.

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