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The Role of Institutions in Policy Formation and Delivery

INTRODUCTION

The role of institutions in agricultural policy refers to the way agricultural policy, or any economic policy for that matter, depends on the particular institutional background prevailing in a particular country. Thus, within countries, the same institutional background applies across different economic policies while, between countries, the institutional background differs and is likely to lead to different policy frameworks and different policy delivery systems for dealing with the same problem. This is apparent in the international aid arena (Johnson, 1999) and in regional groupings of independent countries like the EU with overriding needs for policy coordination (Williams, 1997).

By institutions I mean any established law, custom or practice (*Oxford English Dictionary*). In the realm of government, the set of rules and codes for governing form *recognizable policy making and forming institutions* such as parliaments, parties and bureaucracies. Governments pass legislation to regulate trade and commerce, and draw on established law and custom to implement their objectives. These include the existing rules for the sanctity of contracts and the protection of property rights where they exist. Thus the institutional environment includes government law-making bodies, the rules and conventions that surround these bodies, and the formal and informal mechanisms which govern the conduct of commerce and trade.

Institutional analysis recognizes a difference between operational and constitutional levels of decision making (Johnson, D.B., 1991). The operational level consists of decisions made within a given set of already existing and broadly accepted constitutional rules. The latter include voting procedures and means of raising the revenue. The constitutional level is where the rules of the game are established, including the rules for the application of property rights. These constitutional rule are thought to be established in an atmosphere of conceptual impartiality because the future effects on individuals cannot be foreseen (Dixit, 1996, p.13). Once established, they change only very slowly,

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but sometimes cataclysmically (the French Revolution, for example). In between such times, individuals/corporations/governments operate in a relatively unchanging institutional environment and can make operational change in policies, revenue collection and so on (incrementalism).[1]

Davis and North (1971) call the set of fundamental political, social and legal ground rules that establish the basis for production, exchange and distribution the *institutional environment*. Arrangements between economic units that govern the way these units cooperate and/or compete are identified as institutional arrangements. These provide a structure within which members can cooperate and also provide a mechanism that can effect a change in laws or property rights. Buchanan (1975, p.226) makes the distinction between the constitution that governs the whole policy process and individual instances of policy making within this constitution. Williamson (1995, p.174) refers to institutional arrangements as the *institutions of governance* in his transaction cost analyses. Dixit (1996, p.18), following Buchanan, refers to the constitutional framework and policy acts. More recently, Williamson (2000) distinguishes between 'informal institutions, customs, traditions, norms and religion', formal rules of the game, governance or playing the game and neoclassical economics and agency theory. I will use the Davis and North language.

In a given country jurisdiction, the making of economic policy therefore takes place mainly in the area of institutional arrangements. Certain constitutional constraints are taken for granted. Politicians and bureaucrats understand this. Nevertheless, the making of policy is essentially a political process that reflects the pressures that face government decision makers. In this paper, the focus will be on the formation and implementation of economic policies mainly referring to agriculture and the role of institutions in this process.[2]

Since this literature was developed in economies with Western democratic institutions, it is not a universal paradigm for policy making and implementation. On the other hand, the sheer need to organize the business of government in any country will require some rudimentary organization and command structure. Most countries should be able to draw from Western experience to improve their own performance. Nevertheless, it remains imperative for international advisors and country economists to adapt their policy advice to the institutional environment as it is, and not force new structures on to economies already in some difficulty.

This paper first discusses different theories on the political economy of government decision making and implementation, including public choice economics, institutional economics and transaction cost economics. It then discusses policy-forming processes, the respective role of legislators, advisors and interest groups, the new public management and differences between countries. This is followed by an analysis of transaction costs in government and the measures and strategies which might improve the efficiency of the policy process.

POLITICAL ECONOMY OF GOVERNMENT DECISION MAKING[3]

For present purposes, there is a need to distinguish between the traditional view of government as altruistic and benevolent, and government as another bargaining group in the wider game of politics. The two views are represented by the public interest model of government and the individualistic (private) model (Martin, 1990).

The public interest model

In this case, the national interest is achieved by the legislature/congress agreeing to policy acts that evolve from compromise and bargaining among the elected representatives. The national interest can be broadly interpreted as the Benthamite 'greatest good of the greatest number' as seen in the eyes of the decision makers. Civil servants (bureaucrats) provide independent advice to legislators and implement the policies that result from the political decision. A career civil service based upon expertise and non-political appointments is assumed to be available. While this model may appear to be based on the British parliamentary system, it has generic value in providing an example for many other countries (World Bank, 1997, p.79).

The economic role of government in this framework is to introduce policies that increase social welfare. The welfare maximization perspective sees government as an omniscient and benevolent dictator (Swinnen and van der Zee, 1993). Governments intervene in the private economy where it fails to function properly in allocating and distributing resources ('market failure'). The nation state can produce goods, internalize social costs and benefits, regulate decreasing cost industries and redistribute income. In theory, these government actions can redistribute resources to maximize welfare.

Randall (1987) notes the philosophical lineage of this model from Rousseau, Marshall and Pigou. Its basic premises are that the true public interest will be revealed in the political process; that programmes to promote economic activity, to rectify market failure (to internalize externalities), to provide public goods and merit goods, and to promote equality of opportunity, all may be seen as enhancing the general welfare, and that continued vigilance and effort are necessary to ensure that government remains responsive to the public interest.[4]

The individualistic model

This is based on the idea that the nation state is not an organic body apart from the collection of individuals comprising it, and that the central role of economists is to analyse how efficiently government institutions enable individuals to express and realize their preferences about public goods, public services and policies (Johnson, D.B., 1991, p.11). In this view, bureaucrats have their own preferences and goals which they can achieve by enlarging the size and budgets of their agencies. Politicians can achieve their goals by being elected to office and bestowing favours. Interest groups act on behalf of individuals in getting favourable policies passed in the legislature. While this view of government institutions originated in the United States, it also expresses an alternative view of political decision making and administration (World Bank, 1997, p.81).

The model postulates that government decision making is subject to pressures from interest groups, lobbying and voting behaviour, as well as self-interest. Decisions tend to reflect the respective power bases of the participants.[5] Randall (1987) notes the lineage of this model from the writings of Wicksell and Locke, as modified by Buchanan (1987), Tulloch (1983) and others. All rights are assumed to rest with the individual and, to avoid anarchy, individuals rationally delegate some rights to a central authority. The emphasis is on voluntary exchange and freedom of choice, and on individual liberty. 'The cornerstone of liberty is a set of complete, carefully specified, secure, enforceable, and transferable property rights' (North, 1990).

The resulting decisions made by government in this environment are said to reflect the 'private interest point of view'. Outcomes are determined by the weight of the respective power bases of the participants. Interest groups can earn economic rents from their activities by influencing political decision making. Capture of politicians, agencies and civil servants is often observed. While this paper leans to a private interest view of government institutions, it is recognized that some policy decisions are more altruistic than others, and that a cross-section of policies introduced by a government may include elements of both (Martin, 1989, 1990; Johnson, 1994). In this paper, the view is taken that government is conditioned by some of the same forces as private participants in the economy.

The transaction cost model

There is a third alternative. This is the *transaction cost model*, based on an approach originally applied to the structure of firms and emphasizes the relative costs of planning, adapting and monitoring under alternative governance structures (Williamson, 1995, p.175). Decision makers see the need to minimize their aggregate costs of production *and* transaction costs like monitoring and contractual arrangements (Boston *et al.*, 1996, p.21). The literature on transaction costs indicates that some commercial relationships are better suited to market-type arrangements, while others are better suited to hierarchical or rule-driven organizations (Williamson, 1995; Bale and Dale, 1998).[6] In-house provision of services, for example, is likely to be more efficient than contracting out where there is a high risk of self-interest, conflicts of interest, substantial uncertainty, and recurrent, complex transactions.

In recent years, these organizational arguments have been applied to bureaucratic organizations (Horn, 1995; Boston *et al.*, 1996; Dixit, 1996). This has led to greater interest in contracting out services, privatization of government services, arrangements aimed at reducing monitoring costs (between central governments and their agents) and arrangements that reduce opportunism and shirking among agents (bureaucratic ineptitude and corruption[7]).

In terms of policy formation and implementation, transaction costs are emphasized in public administration models of the legislative process (Horn, 1995). Legislators are regarded as self-seeking in using legislation to increase their net political support. Their opportunities are limited by a number of specific difficulties encountered in maintaining their political base and satisfying the supporters of their policies. The legislators who are most likely to remain in power are those who are most successful in overcoming these 'transaction' problems, such as those who are best able to reassure their supporters that the benefits of legislation will not be lost to administrators in the implementation, or undone by subsequent legislatures (ibid., p.14). The primary thesis of this approach is that effective public administration requires that these specific transaction costs be minimized in determining and pursuing society's goals (Zeckhauser, 1995). In most circumstances, agreement on the resulting policies will lead to more efficient organizational forms for society (Williamson, 2000, p.7).

The models of institutional economics emphasize the results of individual and cooperative attempts to solve problems posed in a world of potentially large transaction costs. The new institutional economics is said to be firmly rooted in a second-best world where the *relative efficiency of institutional arrangements* is the concern. It acknowledges the importance of bounded rationality, complexity and costly information, combined with opportunism (Murrell, 1995). These lead to the emphasis on transaction costs and the belief that there may be a variety of institutional arrangements that reduce transaction costs successfully. If cooperative solutions can be found, the emphasis on opportunism is decreased. If satisfactory norms of behaviour can be agreed, transaction costs are also reduced, and efficiency is improved.

The literature emphasizes the innovativeness of individual and collective attempts to solve transaction cost problems.[8] Transaction cost models apply equally to private economic relationships as well as the political sphere, where cooperative efforts can result in new political constructs aimed at solving problems caused by poorly constructed property rights (ibid., p.202):

> The picture emerging is one of complexity – arrangements or institutions of enormous variety and complexity that have been developed to solve the difficult problems that arise when economic interactions are other than the simplest kind of spot transactions. This picture does not give us the simplicity and harmony of the Newtonian system that is echoed in general equilibrium economics, but instead has all the complexity of a catalogue of the earth's ecology.

GOVERNMENT STRUCTURES AND DEVELOPMENTS

Role of rules and institutions

Constitutional economics is the application of economic analysis to *the selection of efficient rules and decision making institutions* through the analysis of transaction costs (Johnson, D.B., 1991, pp.341–5). Rules and conventions essentially make commerce and government easier to conduct. Rules are a time-saving and efficient way of governing how individuals interact. Constitutional rules set the conduct of operational rules and do not need to be changed in the short term. In modern societies characterized by multiple interdependencies and externalities, economic growth and increases in the standard of living have become increasingly dependent upon establishing an institutional environment that provides members of society with the correct economic signals, information and incentives. These institutions of society guide everyday conduct.

The growth of trade and commerce is dependent on such rules (North, 1987, p.421). Modern societies have devised formal contracts, bonding of participants, guarantees, brand names and elaborate monitoring and enforcement systems to protect the individual, but also to create security and confidence in commerce.[9] North calls this *a well-enforced and well-specified system of property rights*. He points out that the resources devoted to transacting are large (although small per transaction) but the productivity gains from trade are even larger. Governments have a coordinating and facilitating role in providing the environment where transaction costs of trade and commerce are minimized and property rights secure and protected. In turn, governments can make international agreements that provide security of contracts and protection of property rights that thus facilitate trade.[10]

Rules can be written (as in constitutions or international agreements) or unwritten (as with common understandings between individuals) (North, 1990, pp.4–6). The conduct and performance of public policy depends on the extent to which a government can design, adapt or modify the written and unwritten rules in its environment. Constitutional rules, particularly, are difficult to change easily, but when they do change, the changes to society may be quite profound.

Rules are important in the study of political and economic institutions. They characterize the institutions surrounding political decision making. They help reduce transaction costs. They make policy formation easier and more productive. They reduce reliance on negotiating skills on a case-by-case basis in the presence of high transaction costs. They provide opportunities for increased efficiency and hence general welfare (Martin, 1989, p.5). But they may increase litigation as they can be appealed and reinterpreted through the courts.

Secondly, they reduce uncertainty and promote solidarity between various participants in the political process through the development of routines and standard procedures (Considine, 1996, p.71). When these settled sets of rules and codes for governing become fully acceptable, they form recognizable policy making and forming institutions such as parliaments, parties and bureaucracies.

From this point of view, institutions are any standardized behaviours which are regularly represented throughout the political or policy system that built up over a long time: 'institutions accumulate historical experience through learning. The results and inferences of past experience are stored in standard operating procedures, professional rules, and the elementary rules of thumb of a practical person' (ibid., pp.71–2). The importance of these means for settling and defining what has been learned cannot be overestimated. Without them any social group would be forced to keep rediscovering the simplest ways of organizing themselves and dealing with the common tasks of survival. As well as being practical devices for solving routine problems, institutions are the group's way of establishing priorities, fixing values and turning profound philosophical problems into simple routines. How long the routine will hold is as important a question as asking what function the institution itself performs.

In discussing these issues, Buchanan (1975) observes that individual policy acts have to complement and fill gaps in the constitution, and to this extent the distinction between the constitutional contract and individual policy acts is often blurred, since the policy act may provide a wide measure of interpretation of parts of the constitution. In almost no circumstances will advisors start with a clean sheet to correct some example of market failure. Given the continuing nature of government policy making, economists should consider the economic problems of government not as agents seeking to maximize economic welfare but as arbitrators, seeking to work out compromises between conflicting claims. Dixit (1996, p.71), emphasizes that constitutions are incomplete contracts, and the distinction between them and policy acts is one of degree, and not kind.

The policy process

The altruistic public interest model sees economic advisors giving independent and objective advice, and political decision makers making inspiring national interest decisions. The individualistic model sees the legislature and the bureaucracy as competing forces with separate agendas, with the emphasis on self-interest. By way of contrast, the actual relationship between the legislature and the bureaucracy is more likely to be characterized by a mixture of duties and obligations with changing emphasis on different aspects of policy making and direction as circumstances change.

In addition, the policy advice process itself is surrounded by considerable uncertainty, and a clear-cut principal–agent relationship is complicated by incomplete information in the exchange, asymmetrical information supply and uncertainty as to any outcomes (Boston *et al.*, 1996). In terms of logistics, the bureaucracy tends to have a monopoly of strategic information relevant to every political decision. While the role of advisors is to process the necessary information that decision making requires and put forward alternative courses of action that might be consistent with the stated aims of the legislature (the passive view), the role of the legislature is to be seen to be acting in the national interest *and* meeting any sectional interests they may represent. Uncertainty about the outcomes of the policy proposed means that the process itself has to be viewed as a probabilistic problem rather than a certainty one.[11]

The passive view of economists as advisors is that they only have a role in analysing the alternatives that face decision makers, and that they should not impose their own values on to the political decision-making process. Government decision making should define some objective function in terms of multiple ends or goals of economic activity (outcomes) and economists should delineate what is possible and the costs and benefits of each course of action (Blaug, 1992, p.128). This is a technocratic view of the policy advice process.

The legislature, or principal in this argument, may well have any number of well-defined and not so well-defined goals. In economic terms these are the preference functions of the legislature and these may articulate national interest concerns and/or private interest concerns. Most commentators, including Blaug, believe that the legislature does not have a well-defined preference function, but is more engaged in a constant search for new preference functions as a result of learning by doing and responding to the changing situation.

Blaug says that any legislative decision maker starts with current activities and gradually begins to define his/her objectives in the light of experience with actual policies. Political decision makers do not try to get what they want; rather they learn to want by appraising what they get. Means and end are indissolubly related, and evaluation of past decisions, or technical advice about future decisions, have to serve this purpose (Trebilcock, 1995, pp.24–9). Thus decision making is disjointed, as it is repeatedly reviewed in bits and pieces (by different people),[12] and it is incremental because it considers only a limited range of policies that differ little from existing ones.[13] *Disjointed incrementalism* does not merely adjust means to ends but explores the ends while applying the means, in effect choosing the ends and means simultaneously (Braybrookee and Lindblom, 1963).[14]

These details of the political decision process are consistent with the transaction cost model of government decision making. Legislators do have a choice of delivery institutions at the policy formation stage; they usually consult the bureaucracy, and constituents/supporters are likely to be consulted as to that decision's effects on them. Once the delivery structure is decided, responsibility passes to the delivery agent (usually the bureaucracy). The problem then becomes one of conduct rather than structure, as administrative details are unlikely to have been highly specified in the original enactment.[15] In this area, bureaucracies have their own sets of rules and conventions, which vary from country to country and institution to institution, but which will probably be the guiding force in determining the continuing delivery of the enacted policy programme. According to Sandiford and Rossmiller (1996), it is this implementation stage which will primarily determine the resulting *performance* of the policy in terms of the original aims.

This paper therefore follows the transaction cost view of the policy-making process. While it adopts features of the public and private interest models, such as self-interest and agency theory, it is quite different in its approach to economic optimization. Instead of seeking to analyse market failure and possible corrective mechanisms, transaction cost analysis diverts attention to the reduction of transaction costs and the rules of governance. The implications of this approach are now more fully debated.

Implications for policy implementation

The above paragraphs have drawn attention to the important dual role of the bureaucracy in advising the legislators of the options that are available to them as well as the carrying out of what is decided. It has been noted that the typical bureaucracy is subject to some of the same pressures as the political arm of government, viz. self-interested activities, responding to interest groups (sometimes representing them) and poor decision making. Bureaucracy also is subject to problems of its own such as developing private agendas, slow response and obfuscating the objectives handed down to them. It has been noted that bureaucratic organizations have been subject to reforms in some countries in the interests of better accountability to the nation and greater efficiency. Finally, it is noted that bureaucratic processes make use of procedural rules to simplify and decentralize tasks, as do other organizations and firms.

The response to these concerns has been to introduce new systems of management in the *public* sector in some countries (organizational changes). The aim has been to bring about better results from the bureaucracy in terms of work output, efficiency and accountability. Some of these procedures have been borrowed from the private sector.

New public management

Aucoin (1990, p.116) has noted how two separate paradigms of government and management in Western democracies have developed. Compared with public choice theory which focuses on the need to re-establish the primacy of representative government over bureaucracy, the new public management focuses on the need to re-establish the primacy of managerial principles over bureaucracy. Managerialism is a set of ideas emanating from sources external to public management per se, namely the literature on private sector or business administration. It stresses that the capacities of modern complex organizations to realize their objectives can be enhanced by management structures and practices that *reduce* bureaucratic procedures in organizational systems.

The two paradigms are likely to introduce a measure of tension, even contradiction, in their application to changes in organization (ibid., pp.125–6). Public choice sees politics as pervading management; that is, politics is present in both the formulation and the implementation of policies. Managerialism sees politics as present essentially in the determination of the basic values or missions, and thus the policies, of an organization. Thus, in one case, politicians must 'tame' the bureaucracy via a concentration of power in the elected representatives, while, on the other, bureaucracy must be freed of excessive controls, especially on line managers. In the first case, the perceived need is to eliminate the capture of the bureaucratic organs of the nation state in order that elected representatives are able to represent the public's interest in public policy; in the second, to give priority to the bureaucratic machine to carry out its designated tasks.

Hood (1991) has identified the following components of the new public management:

- professional management in the public sector;
- use of standards and measures of performance;
- an emphasis on output controls;
- a shift to disaggregation of bureaucratic units;

- an opening up to competitive services;
- the introduction of private sector management styles; and
- more stress on discipline and parsimony in resource use.[16]

These trends suggest a greater stress on management skills as opposed to professional skills, greater accountability through measures of performance, a shift from input controls to output controls, the separation of commercial from non-commercial functions, a shift to contracts and public tendering procedures, more flexibility within departments and cutting costs in the public sector.[17] The adoption of these changes varies from country to country and may often be associated with assistance packages from the IMF and the World Bank.[18]

According to Bale and Dale (1998, p.106), this approach to bureaucratic accountability has five main advantages:

- it establishes clear lines of accountability between government ministers and their departments;
- it defines performance in an unambiguous and measurable way;
- it delegates authority to chief executives;
- it establishes incentives that reward or punish results relative to the agreed outcome; and
- it enables reporting and monitoring performance to take place.

In agricultural economics, a fresh approach to policy accountability has recently been put forward (Sandiford and Rossmiller, 1996; Williams, 1997; Haebig *et al.*, 1998). These papers focus on the implementation of policy rather than on policy formation. The papers use a comparative institutional approach to the delivery of agricultural policy in different countries and originated in the Food and Agriculture Organization (FAO) of the United Nations. The emphasis is on the implementation of policy proposals as enacted in legislatures and asks whether the intent of the legislators is being met in the delivery process and whether such processes meet wider economic criteria such as the meeting of set targets (effectiveness), avoiding unwanted effects (equity and income distribution considerations) and delivering at least cost (efficiency).

The authors suggest using a structure/conduct/performance approach to individual policy programmes to bring out the contrast between the original intentions and actual management of the programme (Koch, 1980). Structure is used to identify what was originally set out in any legislation including design of policy instruments; conduct is used to identify how the legislative programme was interpreted and managed in practice; and performance is used to assess how well the policy system met the original objectives of the programme in terms of delivering the scheduled benefits to the target recipients. The authors suggest that this latter task will be made easier by examining four criteria of performance: effectiveness, efficiency, enforceability and equity (Sandiford and Rossmiller, 1996, pp.7–12; Williams, 1997, pp.7–14).

Institutional environment in different countries[19]

In an international context, the institutions of government vary widely. At the constitutional level, many countries have undergone major upheavals in their parliamentary arrangements. In former colonial territories, some countries have passed through a process of decolonization, temporary experience with a democratic constitution and then various upheavals, to emerge as one-party political states. These upheavals involve major changes in the ruling elites, with consequent changes at the administrative level. In Europe, communist systems of government have been replaced by various versions of liberal–democratic regimes, again with administrative implications (Blondel, 1990, pp.29–30).

The previous discussion has been based on Western government systems, particularly the United Kingdom and its former colonies, and the United States. Within these democratic political systems, there are at least four main subtypes based on the sharing of power and political parties (Weaver and Rockman, 1993): presidential systems, party governments, multiparty coalitions and single party dominants. Outside these types, readers will recognize other possibilities in their experience, such as traditional or monarchic systems, communist systems and countries with popular but generally anti-democratic governments (Blondel, 1990).

Furthermore, there is a wide range of legal systems in use outside Western systems (Lane, 1996). Muslim and Hindu law are examples of religious legal systems, whereas Chinese law and African law represent customary systems. Even in Western countries there is a division between Romano-Germanic law and common law. Romano-Germanic law or civil law emphasizes codification, and the establishment of general principles of law. The most well-known are the five Napoleonic codes enacted between 1804 and 1811.

These distinctions are important because trade and commerce has to be conducted over international boundaries and because international policy advisors are continuously refreshing themselves about these entities for the countries in which they are working. The differences are important in the event of disputes over contracts, the time taken to get resolution of disputes through the courts, and the treatment of property rights. The resolution of these issues raises transaction costs as flexibility is reduced, transactions are slower, litigation is slower and representation/participation is increased.

While policy formation and implementation within countries remain relatively straightforward in institutional terms, it becomes more and more complex when countries are compared or when advisors have frequently to move from one country to another, and when international trade issues are being negotiated.

Sovereignty and the institutional environment

Different countries have different constitutions and hence provide different institutional environments for policy making. I therefore see a variety of experiences in policy formation and implementation as sovereignty differences are observed. The first will be domestic economies of countries which may or may not have some kind of federal structure of government. The second will be regional groupings of countries with common interests (European Union, MERCOSUR, NAFTA). The third will be true multilateral agreements that require overall agreement between participants still with different national objectives (World Trade Organization, WTO). In addition, there is the specific case of multilateral aid organizations which necessarily have to embrace many different country institutional environments.

In single legislature non-federal constitutions, policy formation is determined by the single elite group with electoral or other powers. The conventions of policy making are widely accepted, hence institutional issues scarcely arise in day-to-day policy making. Changes tend to take place in the conventions in line with changes in the electoral cycle, though we should not overlook Buchanan's observation that some policy making eats away at the constitutional conventions. The situation is more complex with federal constitutions, as other semi-autonomous groups have some residual constitutional powers which they readily defend. Institutional arrangements, such as prior consultation, are usually found to achieve coordination in these circumstances. Australian and Canadian policy economists (in federal constitutions) are more aware of these constraints than New Zealand economists (in a single house majority) for example.

In regional economic treaties, more complex arrangements are required for coordination across sovereign boundaries. Williams (1997, p.7) observes that The Treaty Establishing the European Community signed in Rome in 1957, and the Treaty of European Union signed at Maastricht in 1992, and the various amending treaties together provide the constitution of the Union. This allows the Union to make individual acts of common policy (in the form of Regulations, Directives or decisions of the Council of Ministers or decisions of the European Court). Complexity arises in that member states themselves have a diversity of political constitutions, ranging from the Westminster system in the UK to different types of written constitution in other states, all of whom have constitutions with long histories and traditions surrounding them. While the treaties require national acts of legislation to be harmonized so as not to impede the establishment of the common market, the implementation of policies within member states still depends on governments and agencies that are dependent on the traditions of past policies and the national legislation of member states. Williams says of these institutional arrangements: 'There can be no doubt that in the implementation of the common dairy policy these differences have played a part' and affect country performance.[20]

The classic case for multilateral coordination to overcome international transaction costs between nations is the General Agreement on Tariffs and Trade (GATT). The Uruguay Round made great advances in setting up additional trade rules and penalty provisions. One observer (Abbott, 1997, pp. 33–4) talks about the enhanced legalization of the GATT system turning a 'soft law' to a 'hard law' system. Soft law is used by international lawyers to characterize legal norms that do not effectively compel compliance (for example, the recommendations of the Rio Conference on the Environment, 1992). Hard law refers to a system of norms to which a relatively high expectation of compliance exists (the WTO Agreement). Evidence of these trends may be found in the progressive refinement of rules from the general to the specific since the founding of GATT, and the transformation of the dispute settlement system from concensus-based to quasi-judicial in the WTO.[21] Though these advances were not continued at Seattle in 1999, past rounds of the GATT have been instrumental in obtaining quite wide agreement on trading rules for industrial and agricultural goods, and for the technical conditions under which sanitary and phytosanitary measures can be imposed. Without agreed rules in these areas, international trade would break down and severely disadvantage many developing countries. Abbott (1997, p.48) also observes that the success of the WTO rule system depends largely on its emerging relationship to competing rule systems (that is, that of the European Union) and also on changes in the balance of power in the organization (that is, the entry of China and Russia into membership of the WTO).

In terms of the international aid community, reform in former communist country governments in Eastern Europe put some stress on the privatization of property rights in the institutional approach adopted. But Frydman and Rapacynski (1993, p.13) found 'the meaning of privatisation in Eastern Europe has turned out to be complex and ambiguous. Instead of the clarification of property rights and the introduction of incentives characteristic of a captitalistic society, the privatisation process has so far often led to a maze of complicated economic and legal relations that may even impede speedy transition to a system in which the rights of capital are clearly delineated and protected' (quoted by Williamson, 1995). Williamson goes on to observe that getting the property rights right is too narrow a conception of the wider institutional problems which require addressing in these countries.

More recently, Stiglitz (1999, p.4) identified the importance of political institutions and processes in a review of the transition in the Russian economy:

> Policy advisors put forward policy prescriptions in the context of a particular society – a society with a particular history, with a certain level of social capital, with a particular set of political institutions, and with political processes affected by (if not determined by) the existence of particular political forces. Interventions do not occur in a vacuum. How those recommendations are used, or abused, is not an issue from which economists can simply walk away. And this especially so in those instances where one of the arguments for the economic reforms is either failures in the political process or their impact on the political process itself. ... The point is not to refight old battles, but to learn the lessons of the past, to help guide the future.

These comments indicate to me that there is increasing recognition of the role of institutions in making and implementing economic policy. There is a need for national and international policy advisors to understand the processes involved and apply them in their day-to-day work. The very theme of this Conference reflects an increasing awareness of the issues.

ADMINISTRATIVE MODELS: A SYNTHESIS

Transaction costs, policy formation and public administration

The difficulties that political decision makers have in securing continued electoral support are the basis of the transaction cost model of public administration. The difficulties encountered in securing that support create the transaction costs that have to be overcome to achieve lasting and worthwhile policy change. This approach deploys the rationality hypothesis and transaction costs to explain how government policy making and delivery works. It posits that effective public administration requires that these transaction costs be *minimized* in determining and pursuing society's goals (Zeckhauser, 1995). Legislators are regarded as self-seeking in their use of legislation to increase their net political support and lasting power.[22] Their opportunities are limited by the transaction costs of achieving agreement on their proposals. These are the time and effort it takes to reach agreement on legislative refinements and any time and effort that affected private interests have to devote subsequently to participating in implementation and administration; political uncertainty that the legislation will last; uncertainty that the legislation will be administered as intended; and uncertainty about the distribution of private benefits and costs (Horn, 1994, p.13).[23]

The elected/political appointees who are most likely to remain in power are those who are most successful in overcoming these transaction problems, such as those who are best able to reassure their supporters that the benefits of legislation will not be lost to administrators in the implementation, or undone by subsequent legislatures (ibid., p.14). Implementation of legislation will depend on the following agency relationships: (a) the enacting coalition and its constituents (supporters) must rely on administrative agents to implement their proposals – it must delegate to get things done; (b) these agents do not necessarily share the objectives of the enacting coalition and its constituents; and (c) it is very difficult to monitor these agents and create a system of ex post rewards and sanctions that will ensure that they act to protect the interests represented at enactment.

These problems create agency costs: that is, the costs incurred to induce administrators to implement faithfully what was intended in the legislature, and the losses legislators and constituents sustain by being unable to do so perfectly. They include the costs associated with selecting administrators and monitoring their compliance, the costs of using ex post corrective devices (rewards, sanctions and legislative direction) and the cost of any residual non-compliance that produces a difference between the policy enacted and what is implemented (ibid., p.19). There are a number of administrative mechanisms that legislators can draw on that *minimize* these costs: contracting out versus in-house delivery, tax-funded bureaux (departments), non-profit tax-financed regulatory agencies (for example, in the USA) and revenue-earning state-owned enterprises (as in the British system). Each has its advantages and disadvantages (Williamson, 1995, p.179; Horn, 1995, pp.9, 40, 170).

Private interests have a definite interest in *implementation* (Horn, 1995, p.13):

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

Thus, the design of legislation reflects the interests of the different groups taking part in the political process and this reflects society's preferences for equity and efficiency considerations. Most important is what Horn calls the 'commitment' problem. The flow of benefits to legislators is often much more immediate than the flow of benefits to constituents (ibid., p.16). Constituents run the risk that the present or subsequent legislative coalitions might undermine the benefits of given legislation. This is a problem for legislators because forward-looking constituents will assess the durability of future legislative benefits and costs and reflect that assessment in the degree of electoral support they are willing to offer. Thus legislators cannot guarantee constituents durable benefits but they can make binding arrangements that might tie down future legislators. Constituents respond by seeking guarantees that these bindings will be in the implementation design, and that they will be consulted on the matters involved. Competition between different organizational forms will be vigorous enough to ensure that only the most efficient survive (ibid., p.37).

In the same way, the distribution of costs and benefits might explain legislators choosing policies that confine the benefits to marginal voters (those whose votes count) and confining the costs to inframarginal voters (those who are strongly committed to the governing party); or choosing policies that provide benefits in concentrated form and impose costs in dispersed forms; choosing policies that will secure the cooperation of the bureaucracy; choosing policy instruments that minimize real costs over time when they fall on a small group; and choosing policy instruments that bring benefits within the current electoral cycle. Such behaviour is unlikely to be the random product of mistakes, ignorance or stupidity on the part of collective decision makers, but in many cases is likely to reflect systematic incentive structures that the community has built into *political institutions* such as one man-one vote and regular cycles of elections (Trebilcock, 1995, p.27).[24]

Reducing transaction costs in government[25]

Economists and political scientists have developed several alternative working models to explain how governments reach decisions. These, in turn, determine the structure and intended conduct of specific economic policies or acts for agriculture or any other sector or interest. This paper has focused on the transaction costs involved in the day-to-day political process. From the analysis presented, the particular attributes of the process that influence the final shape of policy and delivery have been identified. In political economy terms, these solutions are more likely to represent some kind of consensual optima than a purely economic one (North, 1990, p.15).

Policy advisors, by and large, have to work within these parameters. Economists might take a technocratic view and offer an analysis of the economic effects of different strategies under consideration. Alternatively, they may have need to refer to the institutional parameters that might shape the outcome of the policy act proposed. Dixit (1996, pp.149–55) argues that this is inevitable and the advice process is not complete without it: 'the policy process should be thought of as an evolving, dynamic game; perhaps the economists' role should be viewed in a very similar manner'.

Policy advisors will continue to control the information base. In the case of particular policy acts, evaluation of past policy proposals should be an established part of the activities of a responsible bureau in central government. Evaluation (including monitoring) should include testing for the efficiency and equity effects of a given policy programme, as well as the distribution of benefits and costs. Evaluation of past policy and new proposals should take account of the institutional environment along the following lines (following Horn, 1995):

- aims of the enacting legislation (structure);
- consultation with stakeholders at the enactment phase of the legislation (design);
- choice of delivery instruments (efficiency);
- behaviour of the delivery agents (conduct);
- performance in terms of the original aims; and
- getting commitment from the respective parties.

The concentration on aims is to separate the aims of the legislators from abstract notions of altruism or economic welfare. At some point the legislation must be treated as a given and evaluated in its own right. In terms of consultation with stakeholders, there has been a widespread recognition that greater public input could be made into the policy formation process. Greater transparency reduces information asymmetries and reduces some transaction costs in the decision-making process (Dixit, 1996, p.149). The Industry Commission in Australia (Industry Commission, 1991) (now the Productivity Commission) and the National Center for Food and Agricultural Policy in Washington, USA (NCFAP, 1994), are organizations which conduct public reviews of policy issues.

There have been public review processes in Australia since 1973.[26] The Industries Assistance Commission was established, on the recommendation of Sir John Crawford, to advice the federal government on assistance which should be given to, or withdrawn from, industries in Australia. Crawford identified the following reasons for establishing the Commission (Uhrig, 1983, p.4):

- to assist the government to develop policies for improving the allocation of resources among industries in Australia;
- to provide advice on those policies in an independent and disinterested manner; and
- to facilitate public scrutiny of these policies.

The Commission was to report back on matters referred to it but could also initiate enquiries under certain circumstances. The Commission later became the Industries Commission and then the Productivity Commission. While the focus was on the need for industry assistance, there is an implication in the aims of the legislation that the implementation of the policy and the suitability of the instruments should also be assessed.[27] In particular, the Australians were concerned with the tariff structure introduced in the 1930s and its implication across sectors (Martin, 1989).

In terms of the behaviour of delivery agents, some countries (for example, New Zealand and the UK) have introduced corporate management systems into the public arena (Aucoin, 1990; Horn, 1995). These emphasize professional management in the public sector, the use of standards and measures of performance, and outsourcing of services which were suitable for such treatment. These represent new 'institutional arrangements' for the conduct of government business and help reduce the transaction costs of implementing policy acts.

Formal proposals for evaluation and review of policy programmes have been systematically introduced in some countries. A wide range of procedures have been introduced in New Zealand[28] and Australia (see World Bank, 1997, p.82), including regulatory impact statements. While introduced in the name of increased accountability, there is also increased concern for (private) compliance costs and distributive effects of policy change. There has also been a political interest in the permanency of policy change with the introduction of a Fiscal Responsibility Act in New Zealand which partially binds future governments to current decisions, thereby reducing the costs of commitment (Horn, 1995, p.191).

Regulatory impact statements (RISs) have been introduced in both Australia and New Zealand. A statement must be prepared for all new or amended regulations that directly or indirectly affect business, or restrict competition. In Australia, each statement should be prepared early in the policy development process, and should set out (among other things), the options (regulatory and/or non-regulatory) that may constitute viable means of achieving the desired objective(s), an assessment of the impacts (cost and benefits) on consumers, business, government and the community of each option, and a consultation statement (Productivity Commission, 1998). These directives are aimed at reducing the cost of mistakes, the cost of unacceptable outcomes and the costs of poor implementation.

The new institutional economics has changed the thrust of policy analysis away from market failure to design and delivery issues. The broad aim is to devise rules and procedures that reduce transaction costs and improve outcomes. Clarification of the appropriate methodologies will enable policy analysts and advisors to governments to design better policy programmes, as well as focus international advisors on the different institutional environments they will encounter (Williams, 1997; Johnson, 1999).

SOME CONCLUSIONS

This survey of the role of the institutional environment in policy making and implementation has focused on political economy models of government. It has assumed that elected representatives are motivated by a desire to play a part in economic design making as long as they can. This will be reflected in their attitude to economic planning and legislation by attempts to bind future legislatures to present plans, and by attempts to prevent their aims and desires from being obstructed in the implementation of policies. Incumbent legislators will also seek cooperation of powerful interest groups so that their electoral support base is more secure.

From this viewpoint, policy delivery cannot be considered separately from the legislation which provides for it. For example, the work of Williams (1997) on European milk policy demonstrates that delivery should be seen in terms of the original aims of the policy rather than abstract notions of welfare. The design of legislation in theory should anticipate the agency and durability problems likely to be encountered. At the end of the day, it is the work of the economic and legal advisors in government to see that legislators' objectives are met, within the political parameters set out.

In the international arena, agreement on institutional rules is more difficult. The present arrangements for the WTO represent an attempt to make rules more enforceable for the management of trade disputes. At the same time, the agreements continue to protect national sovereignty in economic decision making in line with each country's own constitutional arrangements.

International aid organizations also are interested in building institutions for a capable public sector (World Bank, 1997, p.79). The World Bank observes that a gap has opened up between what the state says it will do and what it does – between the formal rules of public institutions and the real ones. Efforts are required to re-establish the credibility of government policies and the rules it claims to live by, making sure they operate in practice. This includes setting hard budget limits, implementing budgets and other policies as approved, making the flow of resources predictable, instituting accountability for the use of financial resources and curbing rampant political patronage in personnel decisions (ibid., p.97).

To lay the foundations of an effective public sector, countries need to concentrate on three essential building blocks (ibid., p.80): (a) a strong central capacity for formulating and coordinating policy, (b) an efficient and effective delivery system, and (c) motivated and capable staff. The transaction cost model put forward in this paper provides a very satisfying explanation of the reasons for these policy implications.

NOTES

[1]Stiglitz (1999) uses the French Revolution and incrementalism as metaphors in a recent discussion of transition economics in Russia.

[2]I shall argue that policy implementation cannot be considered separately from policy formation.

[3]For a recent review of this material, see van der Zee (1997). He aims to integrate the motives and activities of interest groups, politicians, voters and bureaucrats involved in agricultural policy formation.

[4]Recent critiques of this literature include North (1990, pp.15–16), Dixit (1996, p.9) and Williams (1997, pp. 5–6). The introduction of transaction cost analyses has shifted the emphasis away from welfare models to cost minimization models. According to Dixit, many economists have been reluctant to follow this path.

[5]Standard welfare models posit the participants as producers, consumers and taxpayers. Political preference models show that quite a diversity of groups can be identified, down to individual lobby groups. Rausser *et al.* (1995) identify (in an East European context) producers seeking economic surpluses, the *nomenklatura* (the old ruling elite) seeking their former rents and a central reform group interested in social welfare. Zusman and Amiad (1977) identify the interest groups as kibbutz (cooperative) farms, moshav (family) farms and consumers. Beghin (1990), for Senegal, uses farmers, consumers and the marketing board/government complex.

[6]Williamson (1995, pp.171, 193) maintains that institutions are important, and they are susceptible to analysis; the action resides in the details; positive analysis (with emphasis on private ordering and de facto organization) as against normative analysis (court ordering and de jure organization) is where the new institutional economics focuses attention, and taking institutions seriously is the first step. Working out the microanalytic logic of economic organization is the second. The argument is that the institutional economics approach, especially of a bottom-up kind, helps inform these issues.

[7]For a recent discussion of political stability and malfeasance, see Johnson (1999). The OECD member countries, and five others, have adopted a Convention on Combating Bribery of Foreign Public Officials in International Business Transactions to establish bribery as a criminal offence (OECD, 1997). The Commonwealth Heads of Government meeting in Durban in 1999 apparently discussed an expert report on corruption, details of which have not been released.

[8]Williams (1997, p.9) has shown that transaction cost models are highly applicable to EU milk policy.

[9]Different countries will have different attitudes to property rights and the resolution of conflict. Civil codes arising out of the Napoleonic reforms in France tend to circumscribe commercial relationships and hence property rights in order to protect the state. Codes of this kind are resistant to reform. Effects on governance and commerce include high direct transaction costs, inflexibility, slow speed of transactions, the need to resort to the courts to resolve conflict, and a low level of effectiveness and efficiency of litigation (Sandiford-Rossmiller and Rossmiller, personal communication).

[10]For an application of this argument to third world countries, see North (1990, p.67). Transaction costs are sometimes so high that no transaction takes place.

[11]This means that policy advice to decision makers always carries a risk element, in that future outcomes cannot be predicted very accurately.

[12]Braybrookee and Lindblom (1963) see disjointedness arising out of the US political system where responsibility is divided between Congress and the President.

[13]Incrementalism is not a universal phenomenon. Hall (1986, pp.8–9) points out that officials in Britain and France can display considerable forcefulness and real innovative capacity when occasion demands.

[14]Blaug only refers to one part of the Braybrookee and Lindblom model (B&S). B&L (1963, pp.66–79) actually distinguish between incremental and large change, *and* low and high levels of understanding. The model adopted by Blaug, and used here, is the incremental change and low understanding model. Decisions with incremental change and high understanding can be dealt with by the administrators; but decisions with large change, with low or high understanding, are not easily explained by the B&S approach. Constitutional economics also makes use of the distinction between small and large changes.

[15]In US farm legislation, the struggle for power between the Congress and the executive has resulted in larger and larger farm bill texts. Farm Bills in the 1960s and 1970s ran to 200–300 pages; the 1996 FAIR Act exceeded 1600 pages as Congress sought to bind the hand of the Secretary of Agriculture (Sandiford-Rossmiller and Rossmiller, personal communication).

[16]For a comprehensive discussion of the applicability of these components to developing countries, see Bale and Dale (1998).

[17]Schwartz (1996) links these reforms to restructuring the institutional fabric of the state in order to change the behaviour of both citizens and public sector employees by changing the incentive structure these groups face. The aim is to insulate the state from rent seeking and to reduce the role of the state in economic affairs.

[18]As Aucoin (1990) points out, reforms have followed the application of business principles to the state, and from the application of organizational theory to the state. The two seem to be inextricably mixed in actual application. The delivery of agricultural services by governments has certainly been subject to reform in many countries as fiscal imperatives close in. For discussion of livestock services in Africa, see Leonard (1993) and Leonard *et al.* (1999); for contracting out in developing countries, see Hubbard (1995); for alternative policy advice see Storey (1996); for irrigation services in Bolivia and extension services in Ecuador, see Haebig *et al.* (1998).

[19]Dixit (1996, pp.107–12) notes the peculiarities of history, geography, culture, population, language and other characteristics which determine the operation and evolution of politics and institutions in a country. He suggests there is a general merging of systems towards the US system owing to the international mobility of people and ideas. Weaver and Rockman (1993) provide a detailed comparison of parliamentary systems and presidential systems.

[20]North (1990, p.1010) asks, why does a fundamental change in relative prices affect two societies differently? He answers that the bargaining power of groups in one society will clearly differ from that in another and adaptations at the margin (in reaching solutions) will reflect this. With different past histories and incomplete feedback on the consequences, the actors will have different subjective models and therefore make different policy choices.

[21]Dixit (1996, pp.124–5) points out the key political conflict in international trade is a Prisoners' Dilemma for the group countries seeking to agree to a more liberal trading system. Each country wishes to restrict its trade – sometimes because it wants to exert some national monopoly or monopsony, sometimes because it wants to pursue a strategic industrial policy that is at least in principle in its national interest, sometimes because the trade barriers are thought to counter some domestic market failure, but mostly because some interest group powerful in its domestic politics wants protection from foreign competition. If all countries give way to the pressure, all will be losers. Therefore they have an incentive to get together and exchange credible promises of retaining open trade regimes. Each retains an incentive to renege on such an agreement and then to try to prevent others from doing the same!

[22]Downs (1957) regarded government, not simply as a black box processing the preferences of citizens, but as a composite actor made up of politicians and voters, each with their own set of objectives and constraints. He observed, 'parties formulate policies in order to win elections, rather than win elections to formulate policies'.

[23]Dixit (1996) appears to have developed a similar approach to Horn (1995) without any cross-citing of references. He identifies costs involved in overcoming the asymmetric distribution of information between parties (signalling and screening costs, costs of monitoring and incentives, auditing costs and costs of misrepresentation), costs involved in managing agents (monitoring, incentives and contractual obligations), costs of agents responding to multiple principals (coordination of policies, playing off one principal against another), and costs related to asset specificity (irreversible investments and lack of durability). Dixit also makes clear that the transaction cost associated with Horn's definition of commitment is the consequent loss of flexibility.

[24]This presentation neatly sidesteps the issue of analysing political behaviour. It says that, if the political institutions in place deliver a clear mandate to one group or another (political parties), then the policy-forming processes are likely to follow the behaviours set out in this section.

[25]This section depends somewhat on the author's experience, but indicates the main issues involved.

[26]G.E. Rossmiller (personal communication) points out that the National Center for Food and Agricultural Policy (NCFAP) plays a similar role in Washington.

[27]Similar processes are carried out by the Australian National Audit Office. These are strong on administrative detail about implementation and alignment with professed objectives, but are not critical of policy per se. Since 1997, Regulatory Impact Statements have been mandatory for all Commonwealth legislation that has the potential to affect business. 'The costs and benefits of regulation are to be weighed up carefully to ensure that the putative [supposed] benefits are not outweighed by excessive economic and financial costs, including the compliance burden on business' (Prime Minister Howard, 1997).

[28]Formal review of policy is provided for by the Audit Office, Regulatory Impact Statements to Cabinet, and the Crown Company Monitoring and Advisory Unit. The Audit Office has a statutory requirement to provide reports on whether public sector organizations operate and account for their performance *in a manner consistent with Parliament's intentions*

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