

2ND MISES SEMINAR

7-8 OCTOBER 2005

An Economic Theory of Bureaucracy: Mainstream Approach Versus Austrian Developments

Laurent Carnis¹

Introduction

The preponderance of the State in our contemporary economies is a major tendency since the 20th century. Different terminologies are used to call this evolution: development of interventionism, state control, socialism, and welfare state...

The state interventions take also different forms: taxation, subsidization, prohibition, obligation, price control, restriction of production, monopoly, and inflation... (Mises 1998 (a)) (Rothbard 1970). It is not our purpose here to propose an economic analysis of the consequences implied by these different hindrances. However, each intervention supposes the existence of a public authority or of a body in charge to apply the policy or enforce the public decisions. These organizations are named bureaucracies and deserve a true investigation, because of their central role in governmental interventions.

Since the seminal works of Weber², bureaucracy is the object of a large literature coming from different fields of investigation: sociology, political science and economy. This paper focuses particularly on a comparison between the public choice approach and the Austrian version, and aims to understand the specificities of each economic approach³. The choice of focusing on the works of Niskanen and Mises is explained by their representativeness for each school of thought⁴.

¹ Transport Economist working for the French National Institute for Transport and Safety Research (INRETS).

He is also associated researcher with LAEP, laboratory of public economics, University of Paris 1. The author is the only responsible for ideas developed in this paper, which do not engage INRETS.

² Max Weber (1952), *From Max Weber: Essays in Sociology*, Routledge and Kegan Paul Ltd. For a critical assessment from the Austrian Economics standpoint, see William P. Anderson (2004) "Mises versus Weber on Bureaucracy and Sociological Method", *The Journal of Libertarian Studies*, (18)1: 1-29, winter.

³ For a previous work on the differences of logic of these theories and the possibilities of establishing some bridges between them, see Carnis 2000, pp. 8-30.

⁴ However we have not to neglect some other works and particularly, Ronald Wintrobe (1998) *The Political Economy of Dictatorship*, Cambridge University Press and Gordon Tullock (1965), *The Politics of Bureaucracy*, Public Affairs Press, Washington, D.C.

We sustain that both of these theories are irreconcilable in their definitions, for the consequences they attribute to bureaucracy and concerning the solutions they propose to avoid the process of bureaucratisation. They rest upon two different conceptions of a free market and a free society. For each element of these theories, we proceed by a critical analysis and circumscribe their differences through a short synthesis.

1 *The raison d'être of bureaucracy: market failure or symptom of socialism*

This section deals essentially with the definition of bureaucracy yielded by Niskanen and Mises. The former focuses more his approach on the allocation of resources. The bureaus exist because of the impossibility for the market to supply some goods or services. They constitute a means of substitution for the defective market. Mises defends another perspective. Bureaucracy is the expression of a more important evil for society: the continuous extension of the State's hindrances in the private business activities and interferences with the personal life of citizens. The bureaucratic management differs from the profit management on the predominance given to the rules against the price system mechanism.

a) *Bureaus as particular productive organisations*

Niskanen's definition of bureaus stresses two essential characteristics. "Bureaus are non-profit organizations which are financed, at least in part, by a periodic appropriation or grant" (Niskanen 1994, p. 15). It implies first, that the difference between costs and revenues are not appropriated by any member of the organisation and second, that the revenues of this organisation does not only derive from the sales of goods or services.

This dichotomy permits to build a matrix by distinguishing the different organizations with the criteria of profitable / non-profitable oriented goal, and the commercial / granted (subsidized) funding. The private firm obeys a profitability criterion and its revenues are generated by sales. The public firm is characterized by the criteria of profitability and is partially subsidized. A third category can be distinguished with a non-profitable character and revenues depending on sales. Consequently, Niskanen's approach imposes strict limits on what defines a bureaucracy: a non-profitable and granted organisation.

	Profitable	Non-Profitable
<u>Commercial</u>	Private Firm	Family, Mutual Company
Granted or Subsidized	<i>Public Firm</i>	<i>Public School, Public Relationship Department of a Private Firm or Bureaus</i>

Table 1: Niskanen's definition of bureaus

For Niskanen, the appropriate distinction follows the criteria of non-profitable dimension and non-commercially oriented goal. In fact, Niskanen's analysis focuses on the productive dimension of bureaucracy. His purpose is to "develop a theory of "supply" by bureaus, based on a model of a purposive behaviour by the manager of a single bureau" (Ibid. p. 5). The author's tasks are to circumscribe the effects of institutional constraints on the outcome (Ibid., p. 9). The primary distinction does not rest upon the fact of the character of the organisation, public or private, coercive or voluntary, but on the particular situation of production (technological constraint and funding problems) (Ibid. p. 19).

According to Niskanen's, the existence of bureaus are explained by the impossibility of the market to provide some goods or services. The market failures are the true origin of bureaucracy. The natural monopoly situation (high fixed costs), the free riding problem (difficulty in collecting fees)

and the external effects (difficulties ... caused by the definition of property rights) constitute the traditional elements for justifying the governmental intervention. Niskanen put his own analysis inside the welfare economy framework (Levêque 1998, pp. 7-10) and makes more explicit the title of his book "*Bureaucracy and Public Economics*".

Niskanen's analysis goes further by asserting the bureaucratic system could perform better than the market process does with an alternative way of proceeding. Loyalty *would* be superior in some ways to price mechanism or it is expected to be⁵ (Niskanen 1994, p. 20).

Another justification for bureaucracy is constituted by the difficulty to specify the supply of services. That is totally different argument from those advanced previously and does not seem well grounded. Indeed, there are numerous examples of goods provided by bureaus in spite of the easiness of defining the supply as the mail or the energy distribution. There are also numerous counter-examples of complex products whose production is insured by private firms (computer technology, research for pharmaceutical firms, biotechnology...) or the movement of contacting out some productions with the private sector (jail management, enforcement activities...) (Benson, 1998, p. 15 and ff.). On a theoretical background, some works on bureaucracy invalidate this approach (Lipsky, 1980)⁶. On the contrary, it would be the bureaucratic provision, which would generate some ambiguity on the production of services in order to make the provision possible and to manage the contradictions of the individual demands. The difficulty of specification does not result of inherent characteristics of the good itself but of the public provision.

Some approximations in Niskanen's analysis can be also noted when he asserted, "Contrary to von Mises's assertion, bureaus provide many goods and services that can be quite adequately marketed." (Niskanen 1994, p. 20)⁷. First, it does not seem correct to use here the terminology "marketed" for bureaucratic provision of goods and services, because of the definition adopted by Niskanen focusing on the characteristics of non-profitability and non commercial goals of these organisations and the justifications given for the existence of such a production. Second, if the objectives given to such organisations cannot be appreciated in terms of sales and profitability, it is not possible to determine if they constitute an adequate answer to the customer preferences and needs⁸. Third, this sentence can be interpreted in a totally different way: that some current bureaucratic activities could be insured by private organizations. Consequently, some other justifications must be advanced to have a fully understanding of bureaucratic organizations. In fact, the limits of Niskanen's approach reflect the boundaries he gives himself to his analysis by neglecting the internal process and the political dimension of governmental interventions (Ibid. p. 11-12).

Niskanen proposes also a general framework to analyse the bureaucratic relationship. This relationship is represented as a bilateral monopolistic situation between a sponsor and a bureau. It is conceived as a bargain between both agents concerning the output and the budget (Ibid. p. 24). Each organization is dependent of the other party. The bureau depends on funding (provided by the sponsor) and the sponsor depends on provision of some goods and services (yielded by the bureau). However, the relationship of dependence is not equally intensive. Niskanen defends the idea that the bureau holds a better bargaining position because it benefits from a better understanding of its own working and its costs of production (Ibid p.29). Moreover the sponsor faces some difficulties

⁵ We can note that it is not demonstrated how loyalty can be superior to the price incentives and how it can solve the market failures. Moreover, this justification of bureaucracy drives Niskanen to inherent contradictions. Indeed, if the bureaucratic process would constitute in a so adapted mechanism, it would not be necessary to deal with the effects generated by bureaucracy. It is also contradictory with the solutions advanced by Niskanen to fight the negative effects of bureaucracy, which are based on price and market incentives.

⁶ "Street level bureaucrats characteristically work in jobs with conflicting and ambiguous goals." "Public service also tend to an idealized dimension that make them difficult to achieve and confusing and complicated to approach." "Agency goals may be ambiguous because the conflicts that existed when programs were originally developed were submerged. A typical mechanism of legislative conflict resolution is to pass on intractable conflicts for resolution (or continued irresolution) at the administrative level." (Lipsky 1980, pp. 40-41)

⁷ This assertion will be discussed through the presentation of Mises' theory of bureaucracy.

⁸ Again, is it correct to speak about customers?

because he has not alternative for the provision of these goods and services and its unwillingness to forego the production (Ibid. p. 25). As Niskanen points out, the conditions of production are particular. On the market, the customers reveal directly his preferences, his needs, and the amount of money is ready to forego against a specific good. The exchange stipulates the quantity and the characteristics of goods or services. Through the bureaucratic process, the revelation of needs and preferences are indirect. The population transmits her preferences to the politicians and sponsors who negotiate or bargain with some bureaus for the provision of goods and services. This two-step process reinforces the position of bureau, which can extract a higher budget to produce a same amount of output. This exploitation is explained by the indirect process of satisfying the needs (asymmetry of information) and also by the possibility of some informal coalitions between the sponsor and the bureau to serve their own interest to the detriment of population (Fiorina and Noll 1978, pp. 256-260). Consequently, the revealed demand of constituents could be very different than that expressed by the sponsor (Niskanen 1994, p. 25).

Niskanen's approach can be summed up around three characteristics. (1) The analysis focuses on the technical problem of production and consists essentially in an inside investigation of bureaucratic organisation. (2) The provision of goods and services by bureaucratic organisations finds some justifications in the inability of the market process to satisfy the demand. (3) Because of the specificity of these goods and services, there is a separation between the funding and the production and the objective of these organisations are not profit oriented. Moreover the demand is not directly expressed but interpreted by politicians, which bargain with the bureau for the determination of the budget and the output.

b) Bureaucracy as a cause of interventionism

According to Mises, bureaucracy can be fully understood only with a comparison with "the operation of the profit motive as it functions in the capitalistic market society" (Mises 1983). Consequently, Mises' approach consists in giving a definition of bureaucracy by stressing what it is not. Bureaucracy constitutes a specific management for the allocation of resources, a system that does not perform with the profit motive. Concerning this last point, we can sustain here a common point between both the mainstream and the Austrian view on bureaucracy. However the interpretation that will be done is radically different and does not imply the same consequences and solutions, which will develop in the next following sections.

Unlike under the profit management system, the allocation of resources by bureaucracy is made through the obedience of the rules. There is no need to satisfy customers and to produce at the best cost. The system of profit and losses plays no role. The predominance of the rule following behaviour distinguishes also the bureaucratic administration of resources by neglecting the importance of entrepreneurship and the role of prices and costs. The rules and regulation determine the product to supply, its characteristics, its price and the method of production (Ibid. p. 50).

More accurately, the essential traits of bureaucratic management are the absence of a check by economic calculation (Ibid. p. 52). The impossibility to control the profitability of economic activities is the direct consequence of operating without the profit motive. Then it is not possible to put a value on this production (Ibid. pp. 52-53).

So, for Mises: "Bureaucratic management is management of affairs which cannot be checked by economic calculation" (Ibid. p. 52). This definition is too elliptic and not clear enough when it is isolated from the rest of the book. This unclear dimension of the proposed definition is reinforced when he asserts: "... we must answer again that bureaucracy in itself is neither good nor bad. It is a method of management which can be applied in different spheres of human activity" (Ibid. p. 48). Let's take the example of some family members exchanging some services without using money and without searching for monetary profit. These activities can be assimilated to a bureaucratic management in Misesian terms. The case of charity organisations with no monetary profit orientation and whose the goal is not to generate turnover obeys a similar pattern. Nevertheless, Mises has not in mind such examples when he deals with the effects of bureaucracy. In fact, for a full understanding of this definition, you have to replace it in the context of the book. Indeed, Mises

limits his definition to the interventions of public bodies and authorities (Ibid. p.22). He excludes *de facto* the private sphere.

Here we can understand easily there is a difference between both these actors, but again what is the criterion of distinction. For Mises, bureaucracy is an instrument, the harm for the execution of orders and regulations. Bureaucracy constitutes an indispensable element for the government. State hindrances cannot perform without bureaucratic intervention; bureaucracy represents a consubstantial element of the existence of government. "There is a field, namely, the handling of the apparatus of government, in which bureaucratic methods are required by necessity" (Ibid. p. 48). Consequently, the bureaucratic process is characterized by the importance of rules in the allocation of resources. Obviously Mises does not assert that rules do not exist or do not play any function in the private enterprise, but the predominance is conferred to the price system and to the profit motive.

The other element to take into account is the ownership dimension. Mises' analysis sustains a differentiation between the private and public ownership. The existence of bureaucracy implies the substitution of public decision for the private ones with the dangers it can create (Hayek, 1993).

Our personal interpretation defends the idea that in spite of that Mises does not dedicate a lot of time to the theory of property rights; they play a great role to understand the theory of bureaucracy. Indeed, the economic calculation debate stresses the importance of private property for the capital goods (Mises 1990 ; 1939), (Pierson et Alii, 1939)⁹. The hindrances of government become possible by substituting public decision for private affairs and by eroding the property rights. That is accomplished in fact with public intrusion in the private life of citizens; it is a progressive destruction of private property rights. By undermining the basis of private property, economic calculation is no more possible. The only way of making decision becomes then the command and control way of allocating the resources. In some way the previous naming, public administration, is more appropriate than the terms of bureaucratic management, which could drive to some confusion with the profit management (Mises 2002)¹⁰.

Mises' definition of bureaucracy can now be clearly established. It is a mode of allocation of resources, the administration of resources resting essentially upon rules and a command-control system; resources which are not legitimately hold by the administrator. Consequently, the negation of the economic calculation reflects in fact the denial of the private property rights and of the freedom for people to decide for themselves. It represents also a process of substitution with a more coercive system based on rules to obey and on a command-control system of decision (Mises 1983, p. 20).

However, Mises asserts society needs a minimum of bureaucracy. In fact, Mises supposes that Society needs a minimum of government intervention. This one has to be circumscribed to the protection of property rights, the properties and the people. This minimal state has to insure social cooperation among the members of society (Mises 1998 (a), p. 149; 1996, p. 37; 1983, p. 20) and to make peaceful interactions between the people possible.

c) Two alternative theories of bureaucracy

For Niskanen, bureaucracy does not constitute a true problem. Indeed the bureaucratic provision represents the possibility of satisfying some needs for which the market process is unable to

⁹ Ludwig von Mises (1990), *Economic Calculation in the Socialist Commonwealth*, Ludwig von Mises Institute ; N. G. Pierson, Ludwig von Mises, Georg Halm, Enrico Barone and F. A. von Hayek, (1939), *L'économie dirigée en régime collectiviste, Etudes critiques sur les possibilités du socialisme*, Librairie de Médecis ; Ludwig von Mises (1939), Le calcul économique en régime collectiviste in N. G. Pierson, Ludwig von Mises, Georg Halm, Enrico Barone and F. A. von Hayek, *L'économie dirigée en régime collectiviste, Etudes critiques sur les possibilités du socialisme*, Librairie de Médecis, pp. 93-132.

¹⁰ The simultaneous use of the term management can let think there is no true difference between bureaucracy and the private firms. See also *Selected Writings of Ludwig von Mises, Between the Two World Wars: Monetary Disorder, Interventionism, Socialism, and the Great Depression*, edited by Richard M. Ebeling, *Liberty Funds*, pp. 372-379.

organize the production. Bureaucracy is an answer to market failures. However, the conditions of public production are not satisfactory because of the indirect expression of citizens' needs. The citizens elect some representatives who bargain with some bureaus. It is a two-step process, with some possible diversions from the original goal at each step. The sponsor can primarily look for satisfying his own preferences to the detriment of the citizen's. Another source of problem consists in the existence of bargain in which there is an asymmetry of information. The bureaucrat holds better information concerning the working of his bureau and the costs of production. Consequently the bureaucrat can extract a higher budget to supply the same output in order to satisfy his own preferences. Finally, the bureaucratic provision implies some problems that are not explained by the public provision itself but by the conditions and the incentives in which the public provision takes place. It has to face with government failures because its agents tend to satisfy their own interests first. Niskanen's approach of bureaucracy constitutes an inside perspective focusing on the condition of production and dealing with the organisational dimension.

Mises develops another conception of bureaucracy. Bureaucracy is understood as the expression of government hindrances. The free market process is hampered by these different interventions. Private properties and freedom to choose for one's own life are under attack. For Mises, bureaucracy means a process of socialisation of means of production. The impossibility of using the economic calculation tools with profit and loss checks represents the consequences of bureaucracy and not the reason of its existence. In some ways, the relation of causality is reversed if we compare with Niskanen's approach. The interpretation is also radically different, because the existence of bureaucracy means the infringement of liberties and the production of goods and services for which it is impossible to determine a value. Then it is not possible to assert that bureaus complete important tasks for customers. The only exception is the acceptance of a minimal state to insure social cooperation between members of society. Mises' approach shares in fact a societal view of the problem. Bureaucracy is not perceived as an organisational problem but as a social stake, a general way of deciding for the allocation of resources which means, simultaneously, destruction and complete chaos (Mises 1983, p. 62).

2 The disastrous effects of bureaucratic organisations

Both approaches of bureaucracy diverge also from the standpoint of the consequences attributed to bureaus. Niskanen points the existence of an overspending tendency of bureaus. The satisfaction of bureaucrats' interests would explain this overextension. Mises' analysis distinguishes three major consequences. Bureaucracy would produce economic, social and psychological effects. Again the different effects stress the two different level of the analysis of bureaucracy: organizational and performance effects for Niskanen; societal effects for Mises.

a) The organisational effect: "the bureaucrat's maximand"

According to Niskanen's approach, the bureaucrat is not a passive and unselfish person. As the other persons, he maximizes his own utility. This assertion constitutes a true break with the traditional presentation of bureaucracy. Not only the bureaucrat's action is not merely motivated by the general welfare or the interest of the State, but his action can be striven for personal advantages. In fact, Niskanen extends the utilitarian model to the field of government (Niskanen 1994, p. 37).

First, Niskanen assumes that the bureaucrat is unable to understand correctly the meaning of the public interest. He is neither "omniscient" nor "sovereign" to be able to give an accurate definition to such a concept. He does not hold all the necessary information. However, Niskanen's approach supposes the concept of public interest exists and it is possible to give an objective presentation (Ibid. p. 36). Niskanen goes further by asserting that there are oppositions of perception of what the public interest means between the different bureaucrats. The struggle for the imposition of personal perception of the public interest makes it impossible to reach such an objective.

This impossibility of reaching the public interest makes possible and easier the actions to satisfy the personal interests. These interests can take the form of higher wages, prerequisites of the office, reputation, perspectives of career, power for the bureaucrat or for the agency, and ease for the

working of the bureau (Ibid. p. 39). It is considered as a discretionary budget (Migué and Bélanger 1974, pp. 24-28). All those advantages are easier to obtain with an increasing budget. With a lax budget, it is possible to hire more bureaucrats, to create opportunities for more manager positions, and to attribute some resources for particular tasks... A bigger bureau gives more prestige to his manager-director, more power for managers on many subordinates...

Niskanen sustains that two different streams promote the overextension of bureau and the increase of budget. There is an internal and external influence. The internal factor results from the rational behaviour of bureaucrat to satisfy their personal utility and its willingness to obtain a discretionary budget. Because the bureaucrat is rational, and rationality means the satisfaction of his own interest, which supposes an increasing budget, Niskanen assumes that the increasing budget as an effect of the rationality of bureaucrat agents.

The second factor promoting the extension of bureaucracy is the survival argument (Niskanen 1994, p. 39). The actions that the bureaucrat have to compose with different constraints. Those constraints results from the influence of the subordinates on the working process and upon which their career depend in part on the decisions taken by the manager. Indeed, the bureau is a collective organisation whose good working and performance depend on the execution of orders and directives by the subordinates. The bureau needs a minimum of efficiency to justify and to ask for a higher budget to the supervisor agency and the supplementary budget permits the manager to reach a part of his objectives. Consequently there is a strong convergence of the interests of bureaucrats to promote an increase of the budget and to succeed in attaining this objective they need each other. The political process explains also the tendency of the expansion of bureaus. Indeed the review officers have their own objectives and their particular interests to satisfy. They need that the bureaus supply some projects and make some proposals for public spending. The existence of numerous projects justifies their position and the necessity they control more resources because they need more to satisfy the demand of public intervention. Those officers show also their ability to define public policy and to propose some alternative projects. "They depend on the bureau to seek out and propose new programs and to make a case for larger expenditures in old programs" (Ibid. p. 40).

Because of the tendency to raise the budget for satisfying personal interests and the inclination of the sponsor to increase the funding of projects, there are few incentives to promote efficient productive methods. Niskanen stresses also the difficulty of identifying the costs production for such organisations, which favours overspending (Ibid. p. 63).

The approach developed by Niskanen to circumscribe the consequences of bureaucracy rests upon a comparison¹¹ between the different forms ¹² of bureaucracy and the free market. Niskanen deduces from such a comparison that the level of output provided by a bureau is twice higher than that yielded for the situation of competition. Bureaucracy means an oversupply situation (Ibid. p. 63). Niskanen also show that the existence of a tendency of a higher rate of increase for the budget and for the level of output of a bureaucratic organization than for a firm in a competitive market. In fact, the bureau benefits from a monopolistic situation from which it extracts revenues from the constituents (Ibid. p. 76).

These general results show an inefficient structure of production, a tendency for an abnormal level of production, an inclination towards an out-of-control of budgets and of costs of production. Globally, bureaucratic organizations tends to produce more than what it would be supplied by a free market and at higher costs.

This general model is declined in numerous particular cases. The objective is the identification of productive effects of organizations, as the *non-profit organizations* or the *mixed bureau* (funded by

¹¹ The comparison method of Niskanen is self-contradictory to the extent that the situation of a provision of bureau is justified by the impossibility of the market to provide goods or the services. Consequently, such a comparison is logically impossible and the result yielded by Niskanen approach cannot hold anymore.

¹² Niskanen distinguishes the situation of the demand constraint. The bureau has to satisfy the demand. The demand is maximal for a marginal value of zero. The situation of budget constraint is characterized by the equality between the costs of production and the budget.

a sponsor and simultaneously by the revenues of its sales)¹³. Niskanen shows that the *multi-service bureau*, which supplies numerous products, increases the inability of the sponsor to hold all the necessary information for controlling correctly the bureau. His analysis stresses that the budget for a single bureau producing both the services is higher than the sum of budgets of different bureaus (Ibid. p. 109). Consequently the bureaus have some incentives to develop their activities, because it generates some asymmetrical situations for information, which permits to extract more resources for a same level of output. The multiplication of activities then insures the creation of opacity for the analysis of costs of production. The tendency of bureaus to develop its activities outside its initial field of intervention can be easily explained.

When the temporal horizon is integrated into the analysis, other perverse effects of bureaus are showed. The bureaucrat will look for a higher rate of spending during his tenure and will favour the spending during the beginning of his tenure (Ibid. p. 114).

The bureaucrat is also incited to promote programs hugely capital intensive. There would be a tendency toward an over-capitalized spending. This implied that the bureaucrat does not try to maximize the value of the bureaucratic organization and promote higher cost processes of production in the early years. This analysis highlights also the relation of dependence towards the manager. Indeed, the process of production, the level of output and the costs of production depend in fact on the personal agenda and the expected tenure of the manager.

b) The societal effects: towards a complete socialization of society

For Mises, the process of bureaucratisation produces three majors consequences. The first one deals with the economic impact deriving from the impossibility of applying economic calculation and of making correctly the allocation of resources. Also Mises identifies political and social consequences with the intrusion of state in business and the private affairs of citizens. The third major consequence has a psychological nature through the impacts generated by bureaucracy on innovation and the vitality of societies.

The economic consequences result from the characteristics of bureaucracy itself. Mises points the fact that the bureaucratic allocation of resources rests upon rules and a command and control scheme of decision. The absence of a private ownership of means of production implies the inability to check the good allocation of resources among the different alternative plans of production (Mises 1983, p. 25).

Indeed, the absence of the private ownership of means of production implies there is no price for the bureaucratic production. As Mises stresses it correctly, that does not mean the bureaucratic output is valueless, but that it is impossible to put a market value for it (Ibid. p. 52). Unlike the market process with which the resources are allocated to the most urgent needs of consumers, it is impossible to know this with a bureaucratic decision. It becomes impossible to discern the existence of profit or losses (Ibid. p. 33). Not only are the bureaus unable to select the adequate plans of production, but also to stop the unprofitable activities. The bureaucrat is unable to correct the eventual errors and to apply the appropriate modifications to previous erroneous decisions. The bureaucratic management constitutes a terrible source of error cycle for the economy with progressive extension of government hindrances and with brutal corrections of its errors (Hülsmann 1998). As Mises asserts: "in this as in many other instances the bureaucrats see in the failure of their preceding measures a proof that further inroads into the market system are necessary" (Mises 1983, p. 35). Because of its deficiencies in the allocation of resources, the bureaucratic management wastes resources and develop losses and frustration among the population.

The economic consequences of bureaucracy are not limited to the general argument of the impossibility of the economic calculation. Mises ascertains also some effects of bureaucracy on the different economic organisations. He analyses the effects associated with the public enterprises. He shows that these enterprises do not operate under the criteria of profit. Sometimes the price is too

¹³ Remember the retained criterion is the cost of production per unit of output.

low to cover its costs of production. In fact, the taxpayers are the real payers by subsidizing these activities (Ibid. p. 65)

In other cases, the consumers can overpay such services, so that it results in withdrawing some resources, which would have been directed towards more urgent needs. In fact, the consumer loses its sovereignty in deciding what he desires to consume and which quality of goods satisfies him the most. Bureaucratisation increases the risk that such organisation is diverted from the satisfaction of consumers to follow its own objectives. Indeed, the profit motive is not available in such allocation so that it is not more possible to drive the resources to satisfy the needs of consumers. The other consequence yielded by bureaucracy is to open the door to more and more deficit for productive activities. The absence of control on the costs of production consists in fact in placing the burden on the public funds and finally on the taxpayers. Their managers become irresponsible spenders (Ibid. p. 69).

Bureaucracy impedes also the private enterprises. Mises defends the idea that bureaucracy is useless for the good working of firms. The criterion of profit is enough to organize from the bottom to the top of the firm. The existence of bureaucratic mechanism inside the private firms results from the hindrances of government inside the private sector. One interference of government with private firms aims at restricting the importance of profit. To reach such an objective, government can compel the firms to pay higher wage to their employees or to pay a bonus to public authorities. The price of the good or of the service can be controlled or the profit per unit of product can be restricted to a threshold. Taxation represents another solution to limit the importance of profit.

Consequently bureaucracy reduces the incentives for entrepreneurs to make profits, to make some efforts in reducing the costs of production. For Mises, entrepreneurs are innovators and bureaucrats are conservatives. Entrepreneurs search for new methods of production and try to modify the present economic situation. They try to improve the conditions of production, to reduce the costs of production and to satisfy the consumers in order to generate higher revenues and profits. The bureaucrats follow the orders and respect the defined rules. Bureaucracy acts as an annihilator of innovation and as a vector of propagation of conservatism and opposition to progress (Ibid. p. 73). More vicious is the tendency to present the entrepreneurs as greedy persons and to diabolise the private sector by presenting business as an immoral activity.

By reducing the incentives to make some innovations and impeding the economic process to reduce the costs of production, bureaucracy places a burden on the people by stopping the process, which permits to increase the purchase power of consumers. It extracts also some resources, which would have been attributed to the consumers and constitutes in fact a hidden taxation.

Bureaucracy means also interferences with the management of personnel (Ibid. p. 75 and ff.). The meddling of government with private enterprises results in the election of politicians to the boards of these firms. The acceptance of private owners to give such positions is considered as a strategic means to smooth the eventual problems with the government. It permits to benefit from the assistance of unions, political parties and politicians. It is used also as means of obtaining some contracts or funds, for removing some constraints or difficulties. In counterpart, the firms have to provide positions for officials and contribute financially to the working of political organisations. The objective is no more to satisfy the customers to obtain revenues and to make profits, but to please the politicians to obtain privileges and protection for their economic activity or insure outlets. Progressively, the State controls the whole economy. The government holds the power to seize the private property or to ruin some enterprises by creating protections, prohibitions or by giving the monopoly to some competitors. The role of entrepreneur loses its initial meaning, because his role is no more to improve the economic situation but to use of diplomacy or bribery to succeed. Mises uses the more appropriate term of adventurer.

With the governmental hindrances, a new philosophy is born: statolatry. Individualism is perceived as a evil and expresses selfishness. The State is conceived as the solution, the means to solve the conflicts between the individuals, the "materialization of morality". The consumers loses their position of dominance in which, they could determine their needs and the means to satisfy them. They do not hold anymore the reins of the production and the conditions of production. Henceforth the State succeeded in reversing the relationship of dependence by giving preponderance to the officeholder. The consumers are transformed in taxpayers with no more consumers' sovereignty. This situation is reinforced because the bureaucrat is also a voter. He plays two roles at the same

time: a consumer for public production and employee in the process of the bureaucratic production. His interest is to increase its own advantages and to raise the budget of its organization (Mises 1983, p. 87). However, there is no means of checking such a perverse situation. More important is the share of public officeholder in a population, higher are their influence and their power of decision through the political process and the election. The particular situation of bureaucrats gives them the opportunity to increase their privileges, their payroll and the size of their bureaus. Tullock develops a similar argument.

Not only is the bureaucratisation process made easier by the central place given to the bureaucrat, but also Mises sustains the existence of a long process of modification of individual preferences. There would be a "bureaucratisation of the mind". Government controls the education by holding the university and by defining the contents of school programmes. A certain intelligentsia whose role consists in justifying the intervention of state and its extension denigrates the free market economy (Hoppe 1995) (Mises 1983, p. 90 and ff.). Finally, the gradual extension of the state transfers the sovereign power of decision from the consumers towards the politician, the bureaucrats or the dictator (Ibid. p. 100).

The psychological impact of bureaucracy concerns the place given to the youth. Mises stresses the mechanism of manipulation, of control and of the forced recruitment of young people within specific organizations whose goal is to put individuals under the control of the political authority from the beginning of their social life. The goal is to break all initiative, innovation, and willingness of building a new world or to bring new ideas. The authority refuses all evolution because it is too dangerous for the present political order. *De facto* this system of control consists in putting the youth in a relation of dependence with regard to the oldest. The young has to follow the rules enforced by the authority and has to obey promptly. The system expresses an authoritarian guardianship of the people. The progress is condemned and discouraged. Bureaucracy drives to rigidity, "ossification", "petrification and death". No more progress is made possible.

The ultimate stage of bureaucracy is the preservation of the privileges of politicians and the complete control of the social life of individuals or interferences with all the dimension and important matters of the life of people. To reach this objective, violence can be used with purges, jail terms and murders. In fact, the concentration of power among few hands and the desire to preserve their political power drafts unavoidably the political leaders to violent confrontations.

c) Common points and radical divergences for the analysis of consequences of bureaucracy

Niskanen's approach focuses on the productive dimension and more accurately on the function of production. His goal aims at identifying the difference of output for each kind of bureau. The comparative approach is used in this purpose and concludes that a bureau produce twice more output than a competitive firm. This approach in terms of partial equilibrium¹⁴ suggests that it is possible to determine the optimal structure of production for bureaucracy and to know it. Niskanen's analysis assumes its existence and an ability to determine it.

Niskanen shows also the importance to take into account the humane dimension of the productive decision. The bureaucrat has his motives and his own interests to satisfy. The public intervention cannot be presented anymore as a mechanical application of means to attain specific ends. First, the bureaucrat benefits from a certain level of autonomy giving him the opportunity to define his own conception of the public good but, also, letting him the possibility to define the appropriate means¹⁵. In a certain manner, Niskanen stresses the importance to take into account the human decisions behind the productive process and the institutional dimension.

Mises proceeds in a similar way. He uses the comparison to determine the effects associated with a bureaucratic organization of production. His comparisons consist in contrasting bureaucracy with

¹⁴ The effects on the output of the others sectors are neglected in the analysis. A higher output in a sector (because of a higher use of resources) for a given amount of factor of production at the society level means unavoidably the reduction of available output for other productions.

¹⁵ For a similar conception for the field of political science, see Michael Lipsky (1980).

the working of a free market, with the role of entrepreneurs, the role of profit and loss system and the importance of prices. The referential used by Mises rests upon the free market economy in the Austrian economics tradition, whereas Niskanen determines the impact of bureaucracy by considering the mainstream model¹⁶. Although Mises is aware of the influence of the bureaucrat on the decisions (as in Niskanen's analysis); he does not give a lot of attention to this dimension. The consequences have to be taken at the societal level. Bureaucracy creates distortions in the economy and causes wastes. At the ultimate stage, it can drive toward chaos and disorder. The economic consequences have to be placed on a larger magnitude than Niskanen thinks. They are not limited to the productive dimension. Bureaucracy means also a policy of subsidization on a large scale; it creates disincentives to innovate and implies the disappearance of entrepreneurs. It constitutes a slow destruction of capitalism. Mises' approach seems also more complete in the sense he deals with psychological, political and social dimension of bureaucratisation. Bureaucracy implies the control of individuals and the different aspects of their life, relations of power between generations of people, and the modification of preferences of individual to promote a more general interventionism. Bureaucracy represents the emergence of a new political order where the power is increasingly concentrated by the political authority, which imposes its own order, and can use violence when it is necessary. These latter dimensions are completely neglected by Niskanen.

3 What are the solutions to escape the downsides of bureaucracy?

The solutions proposed by both the authors to solve the problem of bureaucracy are totally different. Niskanen's goals are to promote competition and to elaborate tools and mechanism, which could generate information for the sponsor. The promotion of competition among bureaucracies and the necessity to control the asymmetry of information has to come close the ideal of perfect competition situation. The perspectives drawn by Mises are more radical. Because Bureaucracy is the symptom of a higher evil for society, that is interventionism, the solution supposes to promote capitalism by economic education and to reduce governmental hindrances.

a) To promote competition, modify incentives and change the rules of decision

Niskanen's approach shows the existence of two productive behaviours for bureaucracy. One situation is characterized by the budget constraint. In this case, bureaucracy has to produce a certain amount of output for a budget. For this case, Niskanen supposes bureau can produce efficiently. The political control by the sponsor would be enough. The other situation is the demand constraint one. The objective is to satisfy the demand. For this task, bureaus hold certain autonomy in the use of resources and can divert a part of them for their own benefit. In this situation, the process of production is not efficient. Then the introduction of competition is expected to shift the demand constraint situation toward the budget constraint one (Niskanen 1994, p. 160) and to generate incentives for enhancing the productive efficiency.

Indeed, the introduction of competition makes possible for the sponsor to choose among numerous bureaus and to increase the number of its possibilities. The existence of many bureaus to produce a same good or service means also for the sponsor the possibility to hold more information on the costs of production and of making some comparisons between the different units of production. A third consequence is the displacement of the constraints the bureaus have to face. Henceforth with the introduction of competition, bureaus have to compose with a budget constraint and no more with a demand constraint. It means bureaucrats benefit from a less autonomy to satisfy their own utility and to extract resources for their discretionary budget (Ibid. p. 198). However, Niskanen stresses that such a reform could promote only a tendency toward a higher productive efficiency

¹⁶ The importance attributed to the asymmetrical situation for the information relative to the productive process implies the referential is characterized with perfect information (hypothesis of transparency for information).

and does not solve the problem of oversupply. The change of the political level of decision¹⁷ (a different sponsor) cannot also guarantee the success in controlling oversupply but it becomes a possibility. In some ways, Niskanen assumes that it is possible to replicate the working of the market (Ibid. p. 195).

The bureaucratic alternatives constitute a first possibility for solving the problems of bureaucracy. A change of incentive constitutes another solution. Niskanen proposes the introduction of different special rewards for the bureaucrat or the bureau, which succeeded in reducing the total costs of production. The goal would not be to maximize the total budget but the difference between the budget and the costs of production. The objective is to reintroduce the mechanism of profit. However, Niskanen is aware that such a reform of incentives can produce some perverse effects (insufficient production in a monopolistic situation, ability for the sponsor to determine and to measure the output) or generate undesirable behavioural feedbacks from bureaucrats (less motivation, strategic behaviours, social acceptance of such mechanisms...). Niskanen deals also with the importance of analysing the productive process and the stakes tied with the control of information. However the production of information can be the object of some manipulations, degraded by its conditions of production. In fact, Niskanen is less inclined to develop such a tool. He thinks the major root of the bureaucratic problem results from the structure of production and its system of incentives. It does not come from a problem of knowledge¹⁸.

Some market alternatives are also available. Niskanen proposes to transfer some part of the bureaucratic production to the private sector and particularly for goods which can be marketed and can be marketable. To avoid the insufficient production by the private sector, he proposes that the government pays or subsidize private production. Niskanen defends then a policy of contracting out some public activities. The non marketable services have to be let to the bureaus.

The political alternatives consist in reducing the importance of the highly intensive demand group and their representation in the organs of decision. Niskanen proposes to modify the conditions of nomination of officials for the sponsor organization, to specialize the representatives on specific programmes to avoid situations of asymmetrical information, to develop watchdog committee and to modify the majority rule (2/3 majority) to increase the control on the demand.

b) An impossible trend to reverse?

Mises does not propose really some solutions to avoid bureaucracy. The last chapter of bureaucracy expresses a kind of pessimism. Socialism would be unavoidable¹⁹. Mises describes a collective

¹⁷ In fact, it depends if the high intensive demand group for the good or the service controls the sponsor. If the change of sponsor drives to reduce the importance of this group for the political decision, there is a high chance to limit the overproduction of the bureau.

¹⁸ Again we should note here a characteristic of the mainstream approach. Knowledge is not a true problem. More accurately for the mainstream, the information does not constitute the true stake. The optimal function of production is supposedly known. The economic problem is only a problem of incentives. "In any case, better analysis and information are not a general solution to the problems of bureaucracy. The superior performance of market institutions is not due to their use of better or more analysis. In fact, most of the formal, "sophisticated" resource allocation analysis in this nation now serves the bureaucracy. The primary differences in the performance of different organizations are due, rather, to differences in their structure and the incentives of managers." (Niskanen 1994, p. 212). Mises shares on this point a totally different view. Indeed, the economic calculation argument shows clearly the importance of information for the allocation of resources to the more urgent needs and the necessity to correct errors (Mises 1990). See also Frédéric E. Sautet (2000) *An Entrepreneurial Theory of the Firm*, Foundations of the Market Economy, Routledge ; Stanford Ikeda (1997) *Dynamics of the Mixed Economy, Toward a Theory of Interventionism*, Foundations of the Market Economy, Routledge ; Israel Kirzner (1997) *How Markets Work: Disequilibrium, Entrepreneurship and Discovery*, IEA Hobart Paper n° 133, Institute for Economic Affairs ; Israel Kirzner (1992) *The Meaning of Market Process, Essays in the Development of Modern Austrian Economics*, Foundations of the Market Economy, Routledge.

¹⁹ We have to replace this analysis in the historical context of the epoch the nazi Germany and the expansion of communism with Stalinist Soviet Union.

impotence to fight the expansion of bureaucracy and interventionism, which appears as a collective choice (Mises 1983, p. 119).

Mises denounces the demagogic thinking and partial analysis, which promotes interventionism as the solution to all problems. The solution rests upon personal economic education. Indeed, the education provided by government belongs to the general arsenal of official propaganda (Mises 1972). This solution seems to us very weak to face to important means of propaganda. Moreover the process of bureaucratisation as Mises sustains transform the preferences²⁰ of individuals towards more interventionism. The members of society would lose their common sense. Only a change in ideology could reverse the process of bureaucratisation (Mises 1991, p. 68).

The optimistic part of the Mises' analysis concerns the self-defeating characteristic of interventionism (Mises 1985, p. 129). At its ultimate stage, interventionism destroys itself.

In fact, the most radical proposition to fight bureaucracy is to eradicate all form of interventionism. According to Mises, there is no middle-way for dealing with the economic problem. There is no middle solution (Mises 1991). Two alternatives are possible: capitalism and socialism. Because the latter is condemned to the inescapable failure, capitalism is the only viable solution, which will succeed in imposing itself (Mises 1985, p. 128).

c) Two irreconcilable ways of understanding bureaucracy

Consequently the analysis proposed by Mises is a strict condemnation of the solutions advanced by Niskanen. It is impossible to mimic the working of the market. The bureaucratic management is characterized by the impossibility of applying the economic calculation and the absence of profit motive. To obtain the performances of the market process, we are obliged to let these activities and these productions in the field of the market. "... the reasoning of the advocates of this middle solution is entirely fallacious." (Mises 1985, p. 128).

Niskanen is aware of these divergences with previous theories of bureaucracy. However his approach in terms of productive efficiency drives him to consider it is possible to transform the bureaucratic practices by injecting methods used through the market process.

He assumes that it is possible to avoid the situation of bureaucracy with too large budget, too low output and the inefficient production of the output. To reach such an objective the institutions and the process by which the demand is revealed and by which the supply is funded have to be changed. These evolutions have to take place on the political market.

Conclusion

Both economic approaches of bureaucracy proposed here share the common view the bureaus do not perform correctly. Niskanen points out the problem of oversupply and of the productive inefficiency. These deficiencies are explained by the political process, which determines the demand and funds the supply. He stresses also the important fact that the bureaucrats research their own satisfaction and have their own conception of public goods and objectives. Mises brings up the problem of allocation of resources through the whole economy. The bureaucrats are unable to allocate correctly the resources because they lack information and cannot proceed with the economic calculation. Bureaucracy rests primarily upon rules and not on the profit and loss system. Not only does it not possible to attribute value to the output, but also there is no means to determine the wastes and correct errors.

Mises and Niskanen disagree completely on the reasons explaining the existence of bureaucracy: market failures for the latter, the extension of interventionism for the former. They are opposed each other on the consequences and the solutions which could be brought. In fact, these

²⁰ For a theoretical approach of the evolution of preferences to explain the expansion of interventionism, see Ikeda (1997).

divergences reflect the opposition between two main schools of liberalism, the public choice school and the Austrian one, and finally two conceptions of liberty and what a free market means (Salin 2000). These approaches seem irreconcilable and all work of synthesis will be without doubt arduous.

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