

## **Chapter 2**

### **Causes and consequences of failure**

Discussing the Mao-induced famine that killed 10 million to 60 million Chinese, Tim Harford writes:

In the 'world of truth' [i.e. markets] ... such disasters cannot happen. Mistakes, certainly, will be made - perhaps more frequently than under central planning. But the mistakes stay small; in market economies we call them 'experiments'.<sup>1</sup>

And in markets – in real, undistorted markets – failed experiments are terminated. This chapter looks at some of the consequences and causes of government failure. Often they accompany and reinforce each other.

#### **Concentration and monoculture**

Government has a long history of intervention in agriculture in the industrial countries. We have seen that perverse subsidies to agriculture in the rich countries have contributed to the devastation of the physical environment, diverted wealth from the poor to the rich and accelerated the massive overcapitalization of farms and rural depopulation. But does the agriculture sector have anything more to teach us about the effects of government intervention?

In much of the countryside in the west, the visual testament to a long history of government involvement is square kilometre after monotonous square kilometre of land devoid of trees, hedges and human beings, devoted to intensive production of crops or pasture. Subsidies have exaggerated this specialisation, partly because guaranteed prices have reduced the risks of on-farm specialisation and partly because capital assets receive favourable tax treatment. So one result of the combination of subsidies and centralised price-fixing and subsidies has been a greater degree of monoculture in agriculture than would otherwise prevail. And, because they are set by central government, subsidies and other interventions have led to a greater degree of monoculture than otherwise. As well, without the high levels of subsidy it's unlikely that farms would be as land-intensive as they are today. Net production would be lower, but so too would use of fossil fuels and prices to consumers. International comparative advantage would operate, so that the west would have imported more from the food-rich developing countries.

Another effect of government support has been the trend towards bigness. We saw in chapter 1 how big landowners and agribusiness corporates capture most of the benefits of support to the agriculture sector. One result has been the high degree of industry concentration in the sector (see box). This is accentuated by a regulatory environment that favours bigness. Regulations, often imposed because of problems caused only by large-scale operators, typically bear more heavily on smaller enterprises, which face higher proportionate compliance costs. The European Union, for example, insists that abattoirs be tiled: bureaucratic logic therefore dictated that a snail farmer was told to tile his packing room, which was classed as an abattoir, up to the ceiling to catch the blood.<sup>2</sup> The sum of these regulations has led to the closure of large numbers of local slaughterhouses, which makes things worse for the animals travelling to slaughter and can accelerate the spread of disease.<sup>3</sup>

a single lot of hamburger meat at one US processing plant was once found to contain parts from 443 different cows.<sup>4</sup>

Economics, animal welfare and aesthetics considerations aside, though, are there any further concerns about a highly specialised, centralised monoculture in agriculture?

First, monocultures are inherently vulnerable to external shocks, whether caused by diseases, or climate, or interruptions to the supply of inputs. On this last point, it's worth bearing in mind that agriculture in the west now depends absolutely on low-cost oil and gas: as raw materials and energy in the manufacture of fertilisers and pesticides, as energy for planting, irrigation, feeding, fertilising, harvesting, processing, distribution and packaging. (Industrial production of fixed nitrogen for fertilizer now matches the natural rate of nitrogen fixation on the planet.<sup>5</sup>) In addition, fossil fuels are essential in the construction and repair of the agriculture sector's equipment and infrastructure, including farm machinery, processing facilities, storage, ships, trucks and roads. Industrialised agriculture is one of the world's biggest consumers of fossil fuels.<sup>6</sup>

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### Industry concentration in agriculture

- The world's top 10 seed companies account for one-half of the global seed trade;
  - The top 10 biotech enterprises account for nearly three-quarters of world biotech sales;
  - The market share of the top 10 pesticide manufacturers is now 84 percent, while industry analysts predict that only three companies will survive the next decade.<sup>7</sup>
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Second, is that the sector as a whole has grown dependent on government support and large corporations, not just for its income level and asset values, but for its sense of direction. When things go wrong in an industry characterised by a monoculture and dominated by a few big players, they go wrong in a big way and in ways to which ordinary people cannot respond, whether as producers or consumers. Government intervention has heightened the potential for disaster but, more drastically, it has *undermined the agriculture sector's capacity to respond and adapt to changing circumstances or scientific knowledge*. An industry that looks to government for price signals has no real need to anticipate or respond to the market. So, thanks largely to along history of government intervention, agriculture in the rich countries is *locked in* to a way of production that is land-intensive, highly specialised, critically dependent on fossil fuels, more vulnerable to shocks, and beholden to the business decisions that very large corporations take in the interests of their shareholders.

Without perverse subsidies or such a high degree of government involvement there might well have been trends towards more specialisation on the farm and a more concentrated agri-business sector. These features are not totally negative, and should not be denigrated in themselves. But without government intervention they would not have gone so far, and they

would have been more reversible, so the sector as a whole would be more resilient to shocks, and more adaptable.

### **Urban monoculture**

Not TV or illegal drugs, but the automobile has been the chief destroyer of American communities ... One can drive today for miles through American suburbs and never glimpse a human being on foot in a public space, a human being outside a car or a truck ... While people possess a community, they usually understand that they can't afford to lose it; but after it is lost, gradually even the memory of what was lost is lost. In miniature, this is the malady of Dark Ages.<sup>8</sup>

It is no surprise to find that in other sectors with which government has been heavily involved for sustained periods, the effect is much as in agriculture: monoculture, an exaggerated dependence on big corporations, and reduced adaptability to changing circumstances. Centralised government thinking with its single-use zoning laws, subsidies to road transport, fossil fuels and construction have meant that the bleak, featureless landscape in our countryside has its counterpart in our sprawling suburbs and ever more similar city centres. (In Britain, for instance, the proliferation of chain stores has seen politicians warning that 'small and independent shops may vanish from the UK's High Streets by as soon as 2015'.<sup>9</sup>) The motor lobby is quick to say that cars and highways represent market forces and freedom of choice. They don't. 'The atomization of our society into suburban clusters was the result of specific government and industry policies rather than of some popular mandate', say the authors of *Suburban Nation*,<sup>10</sup> and they are right. The subsidies and access to government that the road sector receives have nothing to do with market forces. Some argue that the funds extracted from road users exceed the costs of building and maintaining highways. Even if this were true, it ignores the very high social and environmental costs of motoring.

But it doesn't really matter: the bigger point is that it was government, influenced by powerful corporate interests, that chose and subsidised road-based development. And, as in agriculture, our transport systems depend absolutely on fossil fuels: our dependence on oil has been locked in by decisions made decades ago. Any shortage of oil, however short-lived, will see prices leap and intimations of social breakdown. One estimate is that it would take a doubling of petrol prices to reduce US consumption of petrol by 5 percent.<sup>11</sup> And if we now find it impossible to live without cars and low-cost fuel and too expensive or dangerous to travel in any other way, that is a result of government's favouring one particular form of development.

There are other impacts arising from our dependence on oil and cars that are difficult to square with choices that individuals would make in a genuinely free market. Housing unaffordability is one. In 1970, about 50 percent of all families in the US could afford a median-priced home; by 1990 this number had dropped below 25 percent.<sup>12</sup> One reason is the way that planners and developers design our cities. In most residential developments it's now almost impossible for any adult to function without a car. The cheapest cars (in the US) cost around \$6000 a year to run, which at typical mortgage rates equates to \$60 000 in home-purchasing power.<sup>13</sup> For two adults, the impact on housing affordability is obvious.

It is not just a matter of direct subsidies. Take a look at how city governments in the US invoke eminent domain, which gives the state the power to appropriate private property for its

own use. This use is supposed to be in the larger public interest. And in the nineteenth century and much of the twentieth, the individual states did invoke eminent domain primarily for public uses, seizing smallholder land to build roads, parks, railroads, hospitals, and military bases. But since then the public good has been redefined, so that it now interpreted as including economic growth that generates increased tax revenue for a local authority. Joshua Kurlantzick describes how city governments in the US combine with large real estate developers and 'big-box' retailers to exploit eminent domain for their own purposes.<sup>14</sup> The losers are homeowners and small businesses.

Sad though the spectacle of involuntary suburbanisation and urban monoculture in the west might be, the effects of government and the construction industry have been yet more lamentable in Japan. Alex Kerr contrasts the genuine love for nature of Japanese men and women with the destruction being wrought by government and corporations:

It is impossible to get through a single day in Japan without seeing some reference - in paper, plastic, chrome, celluloid, or neon - to autumn foliage, spring blossoms, flowing rivers, and seaside pines. Yet it is very possible to go for months or even years without seeing the real thing in its unspoiled form. Camouflaged by propaganda and symbols, supported by a complacent public, and directed by a bureaucracy on autopilot, the line of tanks moves on: laying concrete over rivers and seashores, reforesting the hills [with a cedar monoculture], and dumping industrial waste.<sup>15</sup>

Government is always more comfortable dealing with big business. It identifies big business with economic success and most of its subsidies and corporate welfare programmes go to the largest companies.<sup>16</sup> Big business has the resources with which to lobby government, distort markets and manipulate the regulatory environment. There are other advantages too in being big: the tax systems in most countries favour those who can readily convert income into capital gains and so pay lower taxes than most small business proprietors. And the complexity of tax and regulatory systems, apart from their bias, also favours those with the resources to understand and best take advantage of them. Small businesses and ordinary people suffer and so too does our physical environment. We end up with bigger, more dominant corporations than we would wish for, and we are locked in to ways of doing things to a degree that we would not, as individuals in a free market, choose ourselves.

### **Government and big business: favouring the large and global**

*Minimum value of "small business" contracts given out by the US last year that went to Fortune 500 firms: \$1.2 billion.<sup>17</sup>*

The rural and urban monoculture, sprawl, suburbanisation: all would have probably gone ahead anyway, without government intervention. The problem is not the monoculture; it's that we have more, possibly a lot more, of it than we really want, and that are locked in to it. Government is so big that when it intervenes it determines the physical and social environment in which we live.

In recent decades some national governments, it is true, have privatised state industries, relinquishing direct control over telecoms, railways and other sectors. But they have taken on a greater role in looking after the interests and needs of big business,<sup>18</sup> partly because of the size and power of the corporate sector, partly because as a big organization itself government

understands big companies and partly because when corporate profits rise so do government taxation revenues.

Corporations and governments support each other in creating ideal conditions for corporate growth and for maintaining government's pivotal role. The large scale of social organization, and the very high degree of specialisation and complexity of our economies, while helpful to corporations, do not therefore arise from undistorted market forces, and do not therefore originate in decisions made by natural persons — though they are certainly maintained by our patronage as viable alternatives become ever more scarce. Corporations have drifted apart from natural persons, and the major influence on our society has changed from natural persons to corporate actors.<sup>19</sup>

The two parties might have nominally equal rights, but they have vastly different resources, which in any actual transaction can be decisive. This is a matter of concern, because the goals of the parties can conflict, and the victims tend to be natural persons and the commons.<sup>20</sup>

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### **Another way of killing small business**

Sometimes government and big business appear to be running a cartel with a single aim: to eradicate small businesses. But the initiative doesn't always come from the vested interests.

The UK's *Daily Telegraph* reported this story:

The misery women go through all over the world queuing for public lavatories would be eased under new principles proposed by the World Toilet Organisation. Guidelines issued at the weekend by the National Environment Agency in Singapore, where the WTO is based, would mean women have at least equal facilities to men.<sup>21</sup>

The code requires medium-sized restaurants, bars and nightclubs to have as many female cubicles as they have male cubicles and urinals. Larger venues, and those such as theatres and cinemas where usage is confined to peak periods, would have to favour women's facilities by a ratio of 14:10. "It's very important where there are a lot of people," said Elisabeth Maria-Huba, a German social scientist. "Women need longer. And in a lot of cases women have to arrange themselves to go out again."

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### **Political monoculture**

The gradual corruption of enterprises by bureaucracy appears to be inevitable. Once any enterprise becomes successful, it is doomed to be taken over by those for whom power and prestige are the central aspects of their lives. The forms are preserved, but the content is lost. Rituals replicate endlessly. This would seem to be a constant of human nature; the trick is to recognize when it has happened and not be fooled by the rhetoric. And if can happen to Christianity it can happen to anything. Including science.<sup>22</sup>

It's certainly happened to universities and research. Lamenting the failure of theoretical physicists to come up with radical innovations or dramatic shifts in our thinking, Mike Alder continues:

Financial managers need to defend expenditures on the basis of maximising their expected return.... That inevitably means that the currently favoured paradigm gets almost all the money. ... So everyone goes for the best bet, and if it happens to be wrong, we all go bust.<sup>23</sup>

An academic monoculture to mirror our rural and urban monocultures? Mr Alder continues:

Philosophers who are good are beyond price, but the mediocre are useless. Scientists tend to be technicians more than philosophers, but the system of rewards doled out by the bureaucrats in charge of the universities these days favours the technicians. It is so much easier to measure their output.<sup>24</sup>

It appears that the same is happening in the world of policymaking. In a bureaucratic setting there are few penalties if you advocate a tried and tested policy – even if it's a proven failure. It's usually better to play safe and do the conventional thing. Bureaucracy stifles creativity and sensitivity to human needs in policymaking just as surely as it does in religion and theoretical physics.

But what about large private sector corporations? Are they any more responsive to the needs of ordinary people? The evidence appears to be that, like governments, they are too big and cumbersome:

Randy Hayes ... once told me of a talk he had with the uber-CEO of the Mitsubishi Company. Hayes said he was able to convince this CEO that Mitsubishi's program of global devastation for short-term profit was not in the long-term interest of either the planet or the company. Hayes achieved this moment of clarity only to have it followed by a far larger and more monstrous clarity for both himself and the Mitsubishi Head: Mr Mitsubishi had no idea how to change the practices of the company, *because the logic that drove the company was both systemic and autonomous*.<sup>25</sup> (Emphasis added.)

Even the short-term interests of parts of a single corporation, then, can be in conflict with the long-term survival of the corporation itself, let alone wider society. Perhaps big corporations, like governments, feel they are too big to fail. Or perhaps they are just so big that most employees have little direct, daily, interactive contact with natural persons in a real market. Most likely of all, those in their higher echelons believe that they can influence the government to disburse legislation or subsidies in its favour. There's plenty of supporting evidence for such a belief: recent (2007-08) turmoil in the financial world has shown that some finance institutions were right in believing that their irresponsible lending practices would be rewarded by a government bailout.<sup>26</sup>

When corporations - and governments - are small in relation to the damage they can cause, then perhaps there's no urgent problem. But when, as now, corporations and governments are huge, their dysfunctionality is a major loss, and possibly a threat to us all. We need more adaptive, diverse ways of achieving our social and economic goals. That is, after all, what

governments are supposed to be doing. Government is sometimes so big it loses sight of this, and has an alarming tendency to focus on means, rather than ends.

### ***Ends and means***

'Hazard Analysis Critical Control Point' (HACCP) ... focuses on identifying the 'critical points' in a process where food safety problems - hazards - could arise... What HACCP boils down to is a system of checklists, form filling and record keeping. ... This system creates a paper trail so that in the event of a problem, the companies or producers implicated can demonstrate that they did their bit and walk away blameless, plausibly denying responsibility. ... A supermarket that poisoned customers by selling contaminated chicken... could use HACCP to show that its suppliers followed correct procedures so it was not at fault.<sup>27</sup>

This represents the triumph of process, and a confusion between means and ends. In this instance the system's overriding objective - the one that permeates the entire system - has little to do with food safety and everything to do with protecting oneself from disciplinary proceedings or lawsuits. Rational policy is subordinated to procedure.

Yesterday I was told by my doctor that she cannot, at present, refer patients suffering from varicose veins for hospital treatment. Today I read your report that hospital waiting lists have come down. Is this coincidence? Are patients with complaints which, while not life-threatening are extremely irritating and debilitating, being denied treatment so that the Government can maintain that it has fulfilled an election pledge?<sup>28</sup>

What happens when process or meaningless numerical targets (see chapter 1) take over? They influence behaviour for the worse. Unless numerical targets are very carefully defined they can be manipulated to generate results quite different from those we actually want to achieve. In the UK secondary schools that encourage their pupils to sit 'softer' subjects such as leisure studies and performing arts can elevate their position in educational league tables at the expense of leading schools that focus on traditional subjects. One school ranked 478th by the British Department for Education and Science plummets more than a thousand places to 1623 when the softer subjects and vocational qualifications are excluded.<sup>29</sup>

The root of the problem here is essentially this: policymakers probably, and government officials and others charged with achieving targets certainly, see shorter hospital waiting lists, a higher place in the educational league table, or (see chapter 1) more organic farming or more recycling as *ends in themselves* rather than means to ends, and the results have been unfortunate, to put it mildly

Policymaking today is inescapably centralised, and important decisions are made that affect larger numbers of people. Given this reality, we have to accept that policy will often be determined by, if not formulated in terms of, quantifiable goals and numerical indicators, at all levels above the very local. Not all these targets are made clear to the public, and policymakers themselves may not set them explicitly. Indeed, governments have a fairly short history of expressing their objectives in terms of meaningful, objectively verifiable outcomes and, to be frank, they are not very good at it, as the examples above and in chapter 1 demonstrate.

Which numbers then should well-meaning policymakers whose remit covers any but the smallest community target?

A starting point, I believe, is that for indicators and targets to be useful they should be inextricably correlated with well-being – and it is the well-being of natural persons that we should be targeting, not that of corporations or institutions, which have entirely different goals.

With national governments being the size they are, and with global schemes bound to assume greater importance, poorly thought out global policies could be disastrous for all of us. Writing about the rush to subsidise biofuel production, George Monbiot says:

It used to be a matter of good intentions gone awry. Now it is plain fraud. ... The reason governments are so enthusiastic about biofuels is that they don't upset drivers. They appear to reduce the amount of carbon from our cars, without requiring new taxes. It's an illusion sustained by the fact that only the emissions produced at home count towards our national total. The forest clearance in Malaysia doesn't increase our official impact by a gram.<sup>30</sup>

I was inclined to think insanity rather than dishonesty but Mr Monbiot may well be right. The implications for the planet are the same either way. Unfortunately, big government is far more concerned with adhering to its own agenda than it is about actually achieving worthwhile outcomes. And what is this agenda? What lies beneath all this confused policymaking, the targeting of means rather than ends, the persistent, destructive subsidies to vested interests; what is the ultimate goal of government, or indeed that of any big organization?

### ***Self-perpetuation: the unacknowledged goal***

According to Tim Coates expenses of UK public libraries are so high in that the average book loan costs nearly £4.00.<sup>31</sup> Of course, libraries do many other things: they answer enquiries from the public, archive local history collections and, increasingly, lend DVDs, CDs and computer games. But still, £4 per book does seem excessive. Mr Coates hints at the likely explanation:

In one London borough with nine libraries, there are nine tiers of "managers" between the counter staff and the local councillor who is responsible for libraries. The Library Manager, who handles admin; the Librarian, who chooses the books; the Area Manager; a Library Management Team; a Senior Management Team; the Chief Librarian; the Head of Cultural Services; the Education Director and, finally, the Council Librarian. Recently I talked to a chief librarian who said that when she started in Glasgow 30 years ago, the library service had a City Librarian and he was the only person not based in a library.<sup>32</sup>

The default setting for any agency in a position of power seems to be to expand or at the very least, to maintain its status. Sooner or later, the founding objectives of the agency cease to be its animating force, and the guiding principle becomes self-perpetuation. Most organizations' growth is circumscribed at some point by opposing power groups, and it is the collision of



these groups that gives us our current political and social system. Big problems arise, though, where the groups have interests in common that are in conflict with those of ordinary people.

Most organizations have procedures for winding themselves up, but few willingly implement them. After foundation, they skip the existential question of whether their organization still meets a need that arises from outside itself. And few organizations consider whether their resources would be better deployed elsewhere. The smaller private sector bodies are kept on their toes by the discipline of opportunity cost: the better use of resources elsewhere, which motivates their controllers to seek higher returns, or be taken over, or go out of business. Public sector bodies, those charged with directly achieving our social and environmental goals, do not face the same disciplines. Nor do very large corporations; those that are big enough either on their own or with government help to distort or subvert the market.

Without such discipline, their purpose wavers. It is the same the world over: from schools to universities, from churches to trade union movements, from political parties to governments. Slowly, imperceptibly (at least to their employees) the organizations' actual objectives change. The nominal, constitutional goals remain in place but, as the world changes, self-perpetuation becomes by default the real purpose of these organizations. And the way to self-perpetuation is often served by methods that have little to do with an organization's stated purpose, or with the interests of society.

Take trade unions. Their aim is to serve the interests of their members. But not on the interests of their members as real people, *but as workers in a particular industry or for a particular company*. Historically, when workers were more specialised and less mobile, trade unions' objectives were congruent with those of their members. Thanks largely to the actions of trade unions in the past, times have changed, and their members' standard of living has risen. But not all unions have adapted. Some have acted against the longer-term, broader interests of their own members by making it impossible for companies or industries to stay viable unless they relocate overseas, or go out of business altogether. Notably immune from such pressure to adapt are the public-sector unions in the rich countries – mirroring the status of their employers as government agencies, exempt from market disciplines.

Perhaps there is little that trade unions organised according to crafts or companies that are obsolescent can do without a radical redefinition of their purpose. Interestingly, there is a precedent for such radical reshaping. With the decline of cathedral building in Europe after the Middle Ages, some guilds of operative (working) stonemasons began to accept honorary members to bolster their declining membership. From a few of these lodges evolved the modern symbolic or speculative Freemasonry, which particularly in the 17th and 18th centuries, adopted the rites and trappings of ancient religious orders and chivalric brotherhoods. These lodges were entirely voluntary. They could not coerce people, whether masons or not, into paying to support them. The old stonemason guilds, without knowing where their adaptive strategy would lead, metamorphosed into something profoundly different.

It's unlikely that today's big government bureaucracies will take that path. Because of their size and dominance, whether at local, national or supranational level, they can insulate themselves from disciplines that would keep their objectives consistent with those of the people they are charged with helping. Their starting point is their existence as organizations, and this severely constrains their capacity to contemplate policies that threaten their role. So,

for example, the swollen agricultural bureaucracies of Europe and the US will – reluctantly - consider some re-orientation of farm subsidies, but not their abolition. All organizations of any size will resist changes that jeopardise their existence, even those that might be in the long-term interests of the people they are supposed to represent. But those that are not subject to external discipline will be more successful at doing so. Sometimes the interests of a government agency can not only diverge, but actually conflict with, those of some of the people that depend on them. So a bureaucracy can, for example, entrench people who depend on welfare bureaucracy in their roles as supplicants, because that is what ensures the continued survival of the bureaucrat.

There need not be anything inevitable or even deliberate about this: it is an observation rather than a law, but it does tend to apply especially to organizations other than those that depend on a free market. This includes private sector monopolies, as well as government and non-profit organizations, trade unions, churches, or state-subsidised schools, or health, housing, religious and social organizations.

It is especially unfortunate that organizational self-perpetuation seems to take precedence even when there is sense of crisis accompanied by a widespread realization that things cannot go on as before, and that outcomes – results – are what really matter. Just such a crisis occurred in New Zealand in the mid-1980s.

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### **Essential terms**

**Inputs** Expenditure, or those factors of production, such as staff, accommodation, other supplies, or other resources, that are used to produce goods and services. Amongst the inputs devoted to lowering crime, for example, would be: police numbers, numbers of patrol cars, and expenditure on policing.

**Outputs** Products that are directly attributable to the performance of an agency, such as number of reports produced and distributed or number of buildings constructed. Outputs of a crime-fighting agency could be: numbers of police on the beat or on patrol at a time, number of police stations open 24 hours a day, number of toll-free phone lines, and the proportion of police emergency phone calls answered within 15 seconds.

**Outcomes, objectives, goals** Circumstances that are desirable *from the point of view of natural persons*. They are likely to be influenced by an agent's outputs and by factors outside agents' control. An outcome that might be targeted by crime-fighting agencies is a crime rate 10 percent lower than in the previous year (as measured by number of reported crimes, or responses to victim surveys). The terms 'objectives' and 'goals' are used synonymously in this text to mean desired outcomes.

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### **Example A: New Zealand state sector reform**

New Zealand was hit hard by the oil price shocks of the 1970s, and by the accession of the UK to the European Union and its protectionist agricultural policy. New Zealand's secure, high-priced market disappeared. In an effort to insulate consumers and producers from these events the New Zealand Government raised barriers to the country's imports of manufactured goods and intensified its intervention in the economy. Initially there was little opposition to this increased government intervention. But it led to inefficiencies that continued to multiply and deepen. Inflation was under symptomatic control - but only through the expedient of a wage and price freeze imposed in June 1982. By mid-1984 a number of acute problems had to be addressed. They included: a fiscal deficit which had reached nine percent of GDP; a growing *public debt* problem, whose servicing costs accounted for 15 percent of public expenditure; a persistent *current external deficit*; and an *overvalued exchange rate*, in support of the low-inflation objective. Unemployment was growing and the economy was stagnating. There was heavy selling of the New Zealand dollar, which threatened to exhaust the country's foreign exchange reserves. In short, most policy instruments were subordinated to the wage and price freeze and it became inevitable that this would have to be removed and that there would then be a resulting resurgence of inflation. By 1984 there was a sense of crisis.

People knew that radical changes in policy were needed. And when they came the changes *were* radical. All sectors of the economy were affected. One of the first acts of the new Labour Government was to announce a 20 percent devaluation of the New Zealand dollar, together with removal of controls on all lending and deposit rates. Exchange controls were removed in December 1984 and the New Zealand dollar has floated since March 1985. Key sectors of the economy - including finance, communications and transport - were deregulated. Export assistance was removed. Tariffs were lowered and the extensive import licensing system was dismantled. Government also began to disengage from commercial enterprises. Many of these were privatised or corporatised (that is, made independent of direct government management, and made accountable on a profit and loss basis). The tax system was overhauled, the central bank given increased autonomy in the pursuit of a single goal: to achieve and maintain price stability.

Over several years beginning in 1988, New Zealand's public sector was thoroughly and innovatively reformed. Tightly held central control gave way to autonomous departments, headed by chief executives with the authority to take decisions relating to the whole of their organizations. Chief executives are now expected to hire and fire staff, negotiate pay, manage their finances and capital assets, negotiate purchase agreements and be held to account for outputs. In the New Zealand public sector:

- accountability for resources and results is maintained through contestable, contract-like arrangements within government,
- performance agreements between government ministers and chief executives lay down standards and expectations for department heads, and
- purchase agreements between ministers and departments specify the outputs to be produced during the year.

The arrangements between ministers and departments specify *ex ante* the outputs they are required to deliver, but leave chief executives free to select the mix of inputs to be used in producing these outputs. This system has been extended to encompass the specification of, and accountability for, longer-term objectives. Since 1994 the New Zealand Government has defined the medium-term outcomes it is trying to achieve in nine ‘strategic result areas’ (SRAs) and linked the outputs delivered by each department to these SRAs through ‘key result areas’, which form the basis of their performance agreements.

The results have been mixed. According to a report commissioned by the New Zealand Government, there have been efficiency gains. However, the transactions costs incurred in negotiating agreements, monitoring compliance and preparing reports have been high, and in many cases have ‘soaked up a substantial part of the efficiency gains’ made from restructuring.<sup>33</sup>

In the context of bureaucratic change the New Zealand reforms were radical. But the reforms were constrained by the then existing institutional structures. At the outset of the reform programme, government departments had been envisaged as achieving specific *outcomes*. But that vision did not carry through.

Instead, outputs became the measure by which departments’ performance is judged. One reason is said to be the self-interest of ministers and public servants, who are unwilling to be scrutinised.<sup>34</sup> Another is that while the supply of outputs can be directly attributed to departments’ performance, outcomes can be influenced by factors beyond their control. As one commentator put it: ‘outcomes are externalities in two-party relationships; therefore it is exceedingly difficult to assign responsibility for them.’<sup>35</sup>

So what happened? It looks very much as though the perceived need to assign responsibility in effect hijacked more thoroughgoing reform. The perception of such a need arises because the players – those whose responsibility is to be assigned – are known in advance and are assumed constant. And who are these players? Why, they are the existing government departments, of course. In effect the New Zealand reforms have *subordinated results to an assumed need to assign responsibility*, which in turn seems to be driven by existing institutional structures and their wish to perpetuate their own existence and degree of control.

### **Example B: The United States ‘Results Act’**

Concerned that the US federal government was more focused on programme activities and processes than outcomes, the US Congress passed the Government Performance and Results Act (‘Results Act’) of 1993. The Act ‘seeks to improve the management of federal programs by shifting the focus of decision-making from staffing and activity levels to the results of federal programs.’<sup>36</sup> It requires federal agencies to submit to Congress strategic plans that outline their missions and goals.

What has been the result? In March 2004, the United States General Accounting Office (GAO) published its assessment.<sup>37</sup> There have been cultural changes within government agencies. Federal managers are now informed by significantly more outcome-oriented performance measures. Goals are both more quantifiable and results-oriented. There is a greater focus on performance measurement, orientation toward outcomes rather than inputs and outputs, and an increased focus on programme evaluation.<sup>38</sup>

All this is very good news. But the GAO report points to certain implementation problems. Importantly, there is no real co-ordination of an agency's annual performance goals with broader strategic goals.<sup>39</sup> And:

...in certain areas, federal managers continue to have difficulty setting outcome-oriented goals, collecting useful data on results, and linking institutional, program, unit, and individual performance measurement and reward systems. Finally, there is an inadequate focus on addressing issues that cut across federal agencies.<sup>40</sup>

The fault, it seems to this author, lies with the way in which strategic goals are chosen. Goals are still formulated *as if the existing agency structure were a given*. Setting outcome-oriented goals should not be the concern of 'federal managers'. It should be a part of the political process: the current agency, with a vested interest in its existence, structure and modus operandi, should not decide what outcomes to target.

Mission fragmentation and overlap contribute to difficulties in addressing crosscutting issues, particularly when those issues require a national focus, such as homeland security, drug control, and the environment. GPRA requires a governmentwide performance plan, where these issues could be addressed in a centralized fashion, but OMB has not issued a distinct plan since 1999.<sup>41</sup>

Another crucial flaw is the small role given to efficiency in achieving targeted outcomes. While US agencies have begun to establish a link between results and resources,<sup>42</sup>

[u]nfortunately, most existing federal performance appraisal systems are not designed to support a meaningful performance-based pay system in that they fail to link institutional performance, program, unit, and individual performance measurement and reward systems.<sup>43</sup>

The GAO found that only one of the six agencies that it looked in more detail clearly linked its costs of the achievement of outcomes.<sup>44</sup>

One difficulty, the GAO reports, is that it is difficult to establish outcome-based performance measures when the programme, or 'line of effort', is not easily quantifiable. 'In some agencies, particularly those that have a research and development component, managers reported difficulties in establishing meaningful outcome measures.'<sup>45</sup>

A second difficulty identified by the GAO is that the federal budget is allocated on an agency-by-agency basis, so it does not provide 'the integrated perspective of government performance envisioned by GPRA'.<sup>46</sup> It would be better if the budget were allocated according to crosscutting theme. As the GAO put it

The development of a set of key national indicators could be used as a basis to inform the development of governmentwide strategic and annual performance plans.<sup>47</sup>

Indeed, the GAO goes on to recommend that there should be a government-wide performance plan.<sup>48</sup>

What we see in the US is that, as in New Zealand, existing institutional structures constrain a truly outcome-based policy. As far as citizens are concerned, efficiency should not be measured as effort per dollar spent, but as improvement-in-outcome per dollar spent. Outcome measures for bodies engaged in long-term activities, for example, research and development, should be subsumed into broader strategic goals. It should not be up to the government or a government agency to monitor how efficient agencies are in achieving sub-objectives. The risk and consequences of underachievement should be borne by the institutions themselves, not by ordinary members of the public. More crucially, the resource allocation should not be on an agency basis. Resources, ideally, would shift in and out of different activities depending on how efficient each activity is in contributing to the achievement of the strategic goals. But if that cannot be done because of the structures of our institutions or the way they work then it is time to subordinate our concept of an institution to the outcomes themselves.

The Government Performance and Results Act does represent a step forward for outcome-orientated government. But existing government agencies have too much say in both the choice of long-term goals to be targeted and in how resources aimed at achieving these outcomes are to be allocated. As in the case of New Zealand, efforts to move towards a system that targets social outcomes efficiently are drastically constrained by the acceptance of the existing institutional structure as a given.

### ***Incentives and pluralism: the best features of the private sector***

The aspersions cast on government need to be balanced by praise for what, at least in the west, we take for granted: the maintenance of law and order, defence against invasion, freedom of expression, and a generally rising standard of living and of health. We suspect that our national governments could do these jobs more efficiently but we ought to recognise that they do on the whole succeed in supplying these vital public goods and services. Similarly, they do a reasonably good job at raising revenue through their tax policies.

But there does appear to be a contrast between government's performance and that of the private sector. Deregulation of western economies and lower barriers to trade over the past three decades or so have vastly increased the range and quality of affordable goods and services. The freer operation of self-interest in the private sector has made many individuals very wealthy indeed. But the less well off and unwaged have gained little, at least in relative terms, and people from all backgrounds suffer from what they perceive to be a deteriorating social and physical environment. Many social and environmental objectives remain as remote as ever, despite large — and, in many cases, increasing — sums of taxpayers' money spent on trying to achieve them. And, as we saw in the case of perverse subsidies, appalling policies can persist indefinitely. Rather than ensuring their swift termination, our political system tends to give their beneficiaries the resources to lobby in favour of keeping them going. These policies, and especially their persistence over decades during which their deficiencies have been widely documented, fuel a suspicion that government could do a lot better. They underpin the contention that governments in the rich world have succeeded in part by transferring some serious social and environmental problems to the developing countries, to the commons, and to future generations.

It is likely that one reason for the failings in government's performance is that there are not sufficiently large numbers of influential people whose prosperity depends on its success. In

the private sector, the success of an enterprise is identically equal to the success of its owners. But the motivation is very different for those agencies, whether they be public sector or non-governmental organizations, who take on the task of solving our social and environmental problems. *The vast majority of spending on social and environmental programmes is carried out by bodies whose success is barely linked to the welfare of those who are their intended beneficiaries.*

Unfortunately governments rarely set explicit targets in the form of outcomes that are meaningful to ordinary people. Their policies are driven by a whole host of factors – anything except outcomes in fact. Very often we hear politicians trying to defuse criticism of public sector schools, or hospitals, or whatever, by pointing to an increase in the budget for these organizations, as if increased spending will automatically lead to improved outcomes. Beholden to existing institutional structures or variants thereof, they cannot imagine that favourable outcomes can be achieved other than by continuing to do existing activities more intensively, whether by increasing funding for existing organizations or by creating new organizations in the same image. In effect, our policymakers sacrifice many worthwhile policy goals to the priorities of institutions.

There are pointers as to what are existing organizations' true priorities. We need only listen to the spirited, and often ingenious, defence of perverse subsidies presented with straight faces by the organizations that stand to lose most if they are withdrawn. Or discover that about half of the funds allocated to humanitarian relief and development aid organizations stays with these bodies.<sup>49</sup>

Such a mismatch between incentives and social goals becomes even more damaging when it perpetuates its own dysfunctionality. It then becomes a self-reinforcing process, which means that the already significant differences between actual policy outcomes and the desired outcomes of natural persons will widen over time. They will continue to widen until we radically re-orientate the way in which we formulate social and environmental policy.

In my view, such a re-orientation in the first instance means targeting and rewarding meaningful outcomes, rather than activities or institutions. That would be a necessary first step, but it is not sufficient. The other necessary step is to ensure that resources are allocated in ways that can most cost-effectively achieve societal outcomes. This is where markets enter into the picture.

### ***Diverse, adaptive solutions***

Targeting outcomes; yes. Providing incentives to achieve these outcomes; yes also. But even that combination would not suffice to ensure effectiveness and efficiency. When the distance between government and people is large, as it is in our highly specialised economies, national or global policy decisions about resource allocation are essentially central planning. Central planners think they know best how to solve economic, social and environmental problems, and their policies embody this assumption. Central planning is ponderous, uniform and slow to adapt, while the sort of complex issues – climate change, violent political conflict, crime and poverty – that we are discussing need exactly the opposite approach. Identifying these problems, articulating them and funding their solution does need centralised global or national bodies, but actually solving them requires diverse adaptive approaches, not central planning.

Markets are diverse and adaptive. Markets encourage people and firms to try different approaches, and also to assess the results of these approaches. Markets also hold people accountable for the results and ensure that ineffective or counterproductive approaches are terminated once they are seen to have failed. They both generate and make good use of a phenomenal information-processing power that central planning simply cannot emulate.

Unfortunately, many believe that market forces must inevitably conflict with social goals. This is partly because a large part of what passes for the ‘market’ in current parlance is anything but: it’s more like large corporations and governments distorting the market to their mutual advantage. But it’s also because the negative impacts of production unleashed by market forces are growing more numerous and more significant.

So it is important to remind ourselves that market forces and self-interest can serve public, as well as private, goals. Often, these private goals coincide with social goals, so that, for instance, the market routinely performs vital tasks such as food distribution and the provision of such indispensables as home medicines, baby needs, furniture and other consumer goods. These are exceedingly complex tasks, which would be impossible for central planners to coordinate. But they are undertaken continuously and reliably by a multiplicity of agents operating in reasonably competitive markets. They are accomplished in ways that fulfil not only the private goals of the firms and consumers involved but also society’s goal of efficient supply of goods and services. This feat results from the combination of the self-interest of large numbers of market players, and their ability to react appropriately to ever-changing circumstances.

Governments tend to be centralist in their instincts. In practice, this has meant that market forces are rarely allowed to play a significant role in organising the production and distribution of those goods and services that governments supply. Government agencies also operate in a non-competitive environment, which discourages self-evaluation.<sup>50</sup> Since the governments of the developed countries now spend a third or more of their economies’ national income, these are significant deficiencies.

The manifold complexity and large scale of such global challenges as violent political conflict or climate change, the proliferation of intricate, obscure relationships between cause and effect: all point to the need for a pluralist solution. No single approach, no planning by a single body, however large, is going to work. We need to find a way of ensuring:

- that the pluralism evoked by market forces allocates the resources we devote to accomplishing our social and environmental goals,
- that any organizations that might arise are entirely subordinated to the achievement of these goals, and
- that rewards given to those who achieve these outcomes are linked to their success in doing so.

The next chapter, and the rest of this book, describe one such way.



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- <sup>3</sup> There were 1980 slaughterhouses in England, Wales and Scotland in 1971-72. In 1995-96 there were only 488. Source: *The BSE Enquiry: the Report*. Crown Copyright 2000; <http://www.bseinquiry.gov.uk/report/volume13/chaptea2.htm#244748>, sighted 17 July 2007.
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- <sup>5</sup> *James Lovelock's Gloomy Vision*, Real Climate: Climate Science from Climate Scientists, <http://tinyurl.com/6kfwva>, sighted 17 July 2008.
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- <sup>12</sup> *The Next American Metropolis*, Peter Calthorpe, Princeton Architectural Pres, 1993, ISBN 1-878271-68-7.
- <sup>13</sup> *Ibid.*
- <sup>14</sup> *Condemnation Nation; retail chains and big business of eminent domain*, Joshua Kurlantzick, ReclaimDemocracy.org (first published by 'Harpers Magazine', October 2005); <http://tinyurl.com/5qhdd8>, sighted 17 July 2008.
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- <sup>18</sup> *The corporation; the pathological pursuit of profit and power*, Joel Bakan, Free Press, 2003, ISBN 0743247442 (pages 154-156).
- <sup>19</sup> *The Asymmetric Society*, James S Coleman, Syracuse University Press, May 1982, ISBN 0815601743.
- <sup>20</sup> For more on this bias towards the big and global, see *Small is Beautiful, Big is Subsidized*, by Steven Gorelick, Dartington, UK: International Society for Ecology and Culture 1998.
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- <sup>23</sup> *Ibid.*
- <sup>24</sup> *Ibid.*

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<sup>25</sup> *The middle mind: why Americans don't think for themselves*, Curtis White, HarperOne 2003, ISBN 0060524367.

<sup>26</sup> For instance, the Bank of England's Special Liquidity Scheme amounts, in the view of the BBC's Business Editor Robert Peston to 'a banking-market bail out of an ambition we haven't seen in this country since the early 1970's and possibly longer than that.'

[http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/04/banks\\_big\\_bailout.html](http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/04/banks_big_bailout.html), sighted 13 August 2008.

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<sup>32</sup> *Ibid.*

<sup>33</sup> *The spirit of reform: managing the New Zealand state sector in a time of change*, Allen Schick, State Services Commission, Wellington, 1996.

<sup>34</sup> *Looping the Loop: Evaluating Outcomes and Other Risky Feats and Essential Ingredients: Improving the Quality of Policy Advice*, [New Zealand] State Services Commission, 1999 ([www.ssc.govt.nz](http://www.ssc.govt.nz)).

<sup>35</sup> *The spirit of reform: managing the New Zealand state sector in a time of change*, Allen Schick, State Services Commission, Wellington, 1996.

<sup>36</sup> *Guide to Assessing Agency Annual Performance Plans*, General Accounting Office of the USA (1997), ([www.gao.gov/special.pubs](http://www.gao.gov/special.pubs)).

<sup>37</sup> *Results Oriented Government: GPRA has established a solid foundation for achieving greater results*, GAO-04-38, US General Accounting Office, March 2004.

<sup>38</sup> *Ibid*, page 12.

<sup>39</sup> *Ibid*, page 7.

<sup>40</sup> *Ibid*, highlights page.

<sup>41</sup> *Ibid*, page 9.

<sup>42</sup> *Ibid*, page 13.

<sup>43</sup> *Ibid*, page 16.

<sup>44</sup> *Ibid*, page 14.

<sup>45</sup> *Ibid*, page 17.

<sup>46</sup> *Ibid*, page 17.

<sup>47</sup> *Ibid*, page 18.

<sup>48</sup> *Ibid*, page 19.

<sup>49</sup> *Lords of Poverty: The Power, Prestige, and Corruption of the International Aid Business*, Graham Hancock, Atlantic Monthly Press, 1994, ISBN 0871134691.

<sup>50</sup> *Why states believe foolish ideas: non-self-evaluation by states and societies*, Stephen Van Evera, MIT Political Science Department and Securities Studies Program, 10 January 2002, version 3.5.