PUBLIC CHOICE, FISCAL FEDERALISM AND INSTITUTIONAL VARIETY IN THE PUBLIC SECTOR: A Theoretical-Historical Analysis for Deriving Lessons for Economies in Transition

Presented for the First International Conference on Public Choice - The Changing Role of Government in the Economy
Vitosha, Bulgaria
March 18-19, 2000

Adapted for Presentation for the Volkswirtschaftliches Kolloquium Ruhr-Universität Bochum, Germany
30 May 2000

Final Text for Publication in the Year Almanac 2000 of the National University Centre Public Sector Economics, University of National and World Economy, Sofia, Bulgaria

JEL code: H77, L31, L33

Prof Dr J.G.A. van Mierlo
Professor of Public Finance
Department of Economics
University of Maastricht
P.O. Box 616
6200 MD Maastricht
The Netherlands
Tel ++31 43 883641/3636
Fax ++31 43 3884878
E-mail: h.vanmierlo@algec.unimaas.nl

This edition: March 2001
Summary

Public Choice, Fiscal Federalism and Institutional Variety in the Public Sector:  
A Theoretical-Historical Analysis for Deriving Lessons for Economies in Transition

JEL code: H77, L31, L33

Until recently, the classical approach to public organisation dominated strongly the theory of public administration in Western Europe. In this classical approach, vertical and hierarchical organisation principles are applied to the organisation of government and of the public sector. This approach results in a mono-centric model of government. Recently, the modern neo-institutionalist approach has been developed, in which horizontal organisation principles are emphasised. This approach results in a poly-centric model of the public sector.

In this article, the mono-centric model of public organisation is criticised from the perspective of the theory of public choice. It is argued, that application of the poly-centric model results in a more efficient and more responsive organisation of the public sector. Application of the poly-centric model demonstrates the potential advantages of the existence of a substantial semi-public sector of nonmarket institutions of private initiative and results in a plea for institutional variety in the public sector. The comparison between mono-centric and poly-centric models of government and public sector is illustrated with a historical-theoretical analysis of nonmarket institutions of private initiative in the Netherlands. Finally, lessons are derived for application to public sector reform in economies in transition.
## Contents

Summary

1. Introduction

2. Mono-centric and poly-centric approaches to the organisation of the public sector

2.1 The classical model of public organisation: mono-centrism

2.2 A neo-institutional model of public organisation: poly-centrism

3. A neo-institutional approach to nonmarket institutions of private initiative

3.1 Functions of nonmarket institutions of private initiative

3.2 Changing functions in the era of depillarisation

4. Functional organisations and institutional variety in the public sector

4.1 The potential value of the functional organisation principle

4.2 New horizontal organisational devices in the public sector

5. Conclusion

References
1. Introduction

The modern welfare state is featured by a mixed economic system in combination with representative democracy. In this modern welfare state, the size of the public sector as well as its activities have grown enormously. Moreover, the public sector has taken the shape of a large and complicated conglomerate of organisations. Some of these public organisations take positions in the centre of the public sector as defined by the tradition of public economics, other public organisations are considered by many author to belong to the periphery of the public sector. This second type of public organisations can be defined as 'nonmarket institutions of private initiative' or 'not for profit-institutions of private initiative' (or 'semi-public' organisations, see Van Mierlo, 1990). In the empirical reality of the economic system, there is no longer clear-cut, theoretically defined distinction between the public sector on the one hand, in which processes of allocation and distribution are coordinated by the budget mechanism, and the private sector on the other hand, in which these processes are coordinated by the price and market mechanism. In American and European economies, a large 'not for profit-sector' has developed, in which the budget mechanism and the price/market mechanism function simultaneously and some times adversarial.¹

The organisation of the public sector in the United States, in Western Europe, and particularly in the Netherlands, is characterised by both 'horizontal (or functional) differentiation' and 'vertical (or geographic) differentiation'. Horizontal differentiation implies the existence of pure and classical public institutions such as: parliament, cabinet, ministries and departments, advisory bodies and general offices of accounts, together with relatively new public institutions, such as: independent government bodies and quasi-autonomous non-governmental organisations (quango's), functional government bodies, and social security institutions. These relatively new public institutions are nowadays considered to be part of the public sector in a broad definition.² Vertical differentiation implies that the organisation of government is dispersed over several hierarchical levels, such as the central government, the provinces and the municipalities, but also local forms of institutional cooperation (for instance: the police authorities), and until recently 'agglomerations' (on the intermediate level between provinces and municipalities), and the supranational level of the European Community. Vertical differentiation corresponds with the principle of territorial or geographic decentralisation and deconcentration in public administration, horizontal differentiation corresponds with the principle of functional decentralisation and deconcentration in public administration. Vertical differentiated organisations are hierarchically subordinated to each other, horizontal differentiated organisations are not subordinated, but coordinated to each other. Both types of organisational differentiation resulted in a large institutional variety in the public sector of many member


states of the European Union, in particular of the public sector of the Netherlands. Both processes of structural differentiation in the public sector are visualised in Figure 1 below.

As a result of these differentiation processes, the institutional relations between the various organisations in the public sector have become very complicated. These institutional relations are not longer characterised by vertical, strictly hierarchical relations of authoritarian commands, but much more by forces of competition and combination, harmony and conflict, coalitions and temporary unions, tribal war and armistice, and so on. The classical holistic government approach is not valid anymore. This approach is substituted by a modern, more pluralistic and atomistic government approach. Some elements of this modern approach are explored in this article, applying public choice theory to the case of the Netherlands. The case of the Netherlands is a specific example of comparable developments in other European countries with respect to the institutional growth of the public sector and can be used as an example for public sector reform in CEE-countries (see also Van Mierlo, 1998).

Figure 1 Two processes of structural differentiation in the organisation of the public sector

The structure of this article is as follows. After this introduction, we discuss in section 2 two models of organisation of government, the classical mono-centric approach and the neo-institutional approach in the science of public administration, resulting in the so-called ‘poly-centric’ model of public organisation. This modern neo-institutional approach of the organisation of government is applied to the semi-public sector of the Netherlands in section 3. In section 4, some implications of this historical-theoretical analysis are explored.

3. This neo-institutional approach in the science of public administration is in some important respects related to the ‘new economics of organisation’ in economic theory. See for a survey of this new branch in economic science Moe (1984).
discussed for the organisation of the public sector in general and for institutional reform of classical government institutions in particular. Finally, a general conclusion is formulated in section 5 of this paper.

2. Mono-centric and poly-centric approaches to the organisation of the public sector

There are at least two different approaches to organisations of the public sector. On the one hand, we have the classical hierarchical viewpoint of the science of public administration, which still dominates in the Netherlands and in many other European countries with a strong, centralised and unitary state constitution, like France and the United Kingdom. In contrast with this classical perspective, a modern neo-institutional approach has been developed in recent years. In the science of public administration, this modern approach has been developed by political science authors Vincent and Eleanor Ostrom (see Ostrom, 1973; Ostrom and Ostrom, 1977). This approach also has been influenced by public choice theorists such as James Buchanan and Gordon Tullock (see Buchanan and Tullock, 1962; Tullock, 1969; Tullock, 1971). The (economic) theory of fiscal federalism (see Oates, 1972) can be considered to be another important inspiration source. For an application of this theory (more precisely the concept of FOCJ: functional, overlapping and competing jurisdictions) to the constitution of the European Union, a recent publication by Frey and Eichenberger (1999) is relevant. Finally, the well-known theory of Tiebout (1956) on competition between local authorities in the supply of public goods must be mentioned. In the Netherlands, the neo-institutional approach to the organisation of the public sector has been introduced by Toonen (1988).

It should be emphasised, that both theoretical approaches can be applied in a positive manner (the study of the organisational functioning of public institutions in empirical reality; description), as well as in a more normative matter (the development of optimal models of organisational functioning of public institutions, possibly resulting in policy advice to improve this functioning in empirical reality: prescription). Both applications are legitimate, but should be distinguished logically (the logical gap between 'sein' and 'sollen' in the analytical theory of science!). In this paper, we will employ both approaches, the classical and the modern perspective on the organisation of the public sector, in a positive as well as a normative manner. The present organisation of the public sector in the Netherlands will be described and analysed with the use of the classical model; this present organisation will be criticised with the use of the neo-institutional approach.

2.1 The classical model of public organisation: mono-centrism

In the traditional view of the science of public administration, it is assumed that order, unity, regularity and decisiveness of public organisation is stimulated by a 'unity of command' by a single decision centre. This mono-centric assumption is a typical characteristic of the classical contribution of Woodrow Wilson, the founding father of the (American) theory of public administration. Also, this assumption is a central

4. This neo-institutional approach has been applied to the organisation of the semi-public, not for profit-part of the public sector (nonmarket institutions of private initiative) in the Netherlands by Van Mierlo (1990); Boorsma en Van Mierlo (1992); and Van Mierlo (1993).
element in the bureaucracy theory developed by the German sociologist and economist Max Weber. This mono-centrism has taken a dominant position in theoretical thinking in public administration until very recently.

From this mono-centric perspective, the power centre of the central government (for instance The Hague in the Netherlands, Paris in France, and London in Britain) is considered to be the 'cockpit', from which the complete organisation of the government should be (and is!) directed. This perspective also results in a vertical and hierarchical model of the organisation of the public sector. Public organisations are directed by direct commands from the political power centre. This mono-centric model resembles strongly to the well-known model of the command economy in the theory of economic systems.

In this model, government has been organised vertically, with the central government on top, provinces in the middle and municipalities on the bottom of the public sector. The underlying organisational design is that of the so-called 'territorial corporation' (in Dutch: 'gebiedscorporatie'): public institutions such as municipalities, provinces and central government, have the political-administrative authority over a certain geographic area, in which all government tasks are executed. On basis of this classical model, a uniform, clear, and neatly arranged organisation of the public sector in the Netherlands has been created. From the same classical model, theoretical arguments are derived to propagate processes of 'scale increase' of the organisation of government. Social and economic developments are increasingly featured by scale increase, and local municipalities in particular should increase correspondently in scale, in order to continue the execution of local public tasks and activities in an adequate way. Municipalities which do not match up these more general developments of scale increase in their own organisation, can no longer carry out public tasks efficiently. Scale increase at the local level is necessary to decrease the costs of the supply of local public goods. Scale increase makes it possible to realise 'scale economies' in the supply of public goods, such as health care and social services, environmental policy, infrastructure and economic activities. This economic argument for scale increase follows logically from the classical model of public administration.

In addition to this argument of establishing scale economies, the economic argument of 'internalisation of externalities' is employed to defend administrative scale increase. Externalities or external effects are effects of production or consumption by (a group of) producer(s) or consumer(s) on the production or consumption of another (group of) producer(s) or consumer(s), which are not included in market prices and hence are not considered in the economic decisions coordinated by the market mechanism. These externalities can be positive (external benefits), but they also can be negative (external costs). If externalities occur, the level on which the provision of public goods and services take place can either be too low or too high. As a result of these spill overs, citizens (policy producers and consumers) in other areas can suffer from the consequences of the public provision without being involved in the political

---

5. The theories of both Wilson and Weber, as well as many other classical theorists on the organisation and the policies of public administration, are discussed in the reader by Korsten and Toonen (1988). A central question in this reader is, how and to what extent actual thinking on organisational and policy problems of the public sector in the Netherlands is influenced by these classical theorists.
decision-making process on this provision. In that case, administrative scale increase is necessary to include these particular areas in the decision process, thus internalising the externalities of public provision into the budget mechanism, by which allocation and distribution of public goods are coordinated.\footnote{Both arguments of 'scale economies' and 'externalities' are also employed in the already mentioned modern 'theory of fiscal federalism'. In the theory of fiscal federalism, the optimal administrative and financial relation between various levels of government in a federal political system is determined. Scale economies and externalities can produce arguments in favour of administrative scale increase, but do not necessarily so. Policy consequences depend on the original situation (actual level of public provision) and on the technical characteristics of the public goods and services involved (the degree of non-excludability and of non-rivalness). Ultimately, the decision to administrative scale increase is a political decision, in which allocative (size of costs and benefits) and distributive aspects (distribution of costs and benefits) have to be evaluated.}

In the classical mono-centric approach, the economic advantages of administrative unity and scale increase of public provision are over-emphasised, and the disadvantages are neglected. Administrative unity and scale increase of public provision, however, do not only yield economic benefits, but they produce also costs.

2.2 A neo-institutional model of public organisation: poly-centrism

In the neo-institutional approach to public organisation, the analysis starts with the statement, that advantages (benefits) and disadvantages (costs) of specific administrative arrangements are not a characteristic of different institutional arrangements and techniques as such, but depend on the type of public goods and services that are provided. The specific qualities of the public goods and services are an intermediate variable between the administrative arrangements on the other hand and the effects in terms of costs and benefits on the other hand.

Citizens' preferences for public goods and services differ (heterogeneous instead of homogeneous preferences). Hence citizens have a strong preference for a variety of public goods and services. In a democratic society, these different preferences have to be matched with a corresponding variety of supply of public goods and services. Therefore, not uniform but multiform public service by (local) governments is required. The local fire brigade requires another type of public organisation than the local health care. Local health care requires another type of public organisation than local housing, education, or infrastructure, and so on.

Multiform service provision requires not a mono-centric but a poly-centric organisation of government: not a government with only one power-centre, but a government with many power-centres, between which a power equilibrium exists. Public provision can be arranged in many different ways and on very different levels of government. There is no such a thing as the one and only optimal public organisation, the one and only optimal administrative arrangement. The policy objective in this approach is not the maximisation of the advantages, ascribed to one administrative model, but to maximise the relative advantages and disadvantages of various administrative arrangements in the public sector in specific situations and responsible for the provision of specific goods and services.

---

\footnote{Both arguments of 'scale economies' and 'externalities' are also employed in the already mentioned modern 'theory of fiscal federalism'. In the theory of fiscal federalism, the optimal administrative and financial relation between various levels of government in a federal political system is determined. Scale economies and externalities can produce arguments in favour of administrative scale increase, but do not necessarily so. Policy consequences depend on the original situation (actual level of public provision) and on the technical characteristics of the public goods and services involved (the degree of non-excludability and of non-rivalness). Ultimately, the decision to administrative scale increase is a political decision, in which allocative (size of costs and benefits) and distributive aspects (distribution of costs and benefits) have to be evaluated.}
In this alternative approach to public organisation, the optimal organisation does not concentrate on uniformity but on multiformity, not on mono-centrism but on poly-centrism. In an administrative optimum, various different public arrangements do co-exist with each other: territorial institutions (distinguished according to the territory, covered by the geographic extent of the local public goods) as well as functional institutions (distinguished according to public tasks, for which they are responsible, such as public water organisations, public environmental protection organisations, public agricultural institutions, social security institutions, public health care institutions, public educational institutions, and so on). These different public organisations, all belonging to a broad concept of the public sector, may cooperate, but they also may compete and even fight against each other.

3. A neo-institutional approach to nonmarket institutions of private initiative

The poly-centric approach to the organisation of pure government institutions (which in the Netherlands are mainly structured according to the principle of vertical differentiation), can also be applied to the organisation of the semi-public system or third sector (structured according to the principle of horizontal differentiation), which in the Netherlands consists of nonmarket, not for profit-institutions of private initiative. Institutions of private initiative are in many respects the Dutch equivalent of the well-known 'voluntary agencies' or 'voluntary associations in the United States of America (see Kramer, 1981). These nonmarket institutions of private initiative should not be confused with market, for profit institutions of private initiative, the commercial business organisations and firms. Nonmarket institutions of private initiative are with regard to their legal status 'private institutions performing public tasks'. Therefore, they do not fit nicely into the market-government, or private-public dichotomy, as presented in the analytical models well-known from the textbooks on (comparative) economic systems or theoretical micro-economics.

These institutions are hybrid organisations. In the first place, they have a private legal status but they perform public tasks: they are private organisations which take part in state functions, which from way back are performed by public organisations, together constituting the state. In the second place, they generate organisational income from many sources: partly their service provision is subsidised by the government out of the public budget, partly they sell their services in market transactions in exchange for which prices have to be paid. These institutions have a mixed organisational income through a system of individual contributions of clients in addition to government subsidies. In the third place, they operate under a mixed steering system. Their production decisions are partly coordinated by the government through the budget mechanism, partly by the market through the price mechanism.\(^7\)

\(^7\) This section is partly based on chapter 3, ‘Verschuivende grenzen tussen openbaar bestuur, non profit-sector en markt in de gezondheidszorg’ in Van Mierlo (1991), pp. 37-57. The original text is updated for actual developments and adapted to the general problem of this article.

\(^8\) This hybrid character of nonmarket institutions of private initiative is elaborated analytically with the application of the neo-institutional approach in Boorsma and Van Mierlo (1992). In their contribution, they derive a typology of public-private organisations from theory, which they attempt to fill in empirically.
Nonmarket institutions of private initiative operate in an area of tension between public and private. Institutions mainly performing public tasks, mainly depending on government subsidies, and being more subjected by the budget mechanism, do resemble more to pure public (or government) organisations. Institutions mainly emphasising their private legal status, mainly depending on market income, and being more subjected to the price mechanism, do resemble more to pure private (or commercial) organisations. The organisational trichotomy public/semi-public/private sectors of the modern economy is clarified in Figure 2 below. In the next section, the organisation of the semi-public system, in which these hybrid nonmarket institutions of private initiative operate, will be subjected to a neo-institutional analysis.

**Figure 2 Organisational trichotomy of the modern economy**

```
<table>
<thead>
<tr>
<th>Pure Public: Economic Coordination by the Budget Mechanism</th>
<th>Mixed Economic Coordination by Budget/Price Mechanism</th>
<th>Pure Private: Economic Coordination by the Price/Market Mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure Public Sector in Broad Definition</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Pure Public Sector (in narrow sense)</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Pure Public/Government Organisations</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Semi-Public Sector ('third sector')</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Pure Public/Government Nonprofit Institutions of Private Initiative</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Pure Public/Government Profit-Institutions of Private Initiative</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
<tr>
<td>Pure Public/Government Market, For Profit-Institutions: Business and Firms</td>
<td>Pure Private Sector</td>
<td></td>
</tr>
</tbody>
</table>
```

3.1 **Functions of nonmarket institutions of private initiative**

In the scientific literature, different functions are mentioned which in a democratic political system can (positive) or have to (normative) be fulfilled by nonmarket institutions of private initiative. In the disciplines of policy sociology and political sociology, and of administrative law, independent administrative

9. It should be emphasised here that the concept of 'function' has two connotations in Europe. Firstly, an empirical connotation (the function is fulfilled in actual organisational life), and a more normative connotation (the function should be fulfilled). The first meaning refers to the Anglo-American function concept as usually employed in the (empirical) social sciences. The second meaning corresponds with the French function concept that is employed mainly in law and in the legal approach. Many times, both function concepts are confused. This confusion also occurs in the debate on the merits and disadvantages of the semi-public system.

arguments have been developed to lay the provision of public goods and services in the hands of not for profit private institutions. These arguments do not relate to the characteristics of the public goods and services provided by these institutions, but to the organisational qualities of government institutions and of private institutions.

These arguments refer to the following five functions (to be) fulfilled by not for profit institutions of private initiative.

1. The function of 'experimental garden of political democracy': nonmarket private initiative is a manifestation of political activism of citizens, by which they can develop their political skills in semi-public organisations in preparation of political participation in public organisations of the nation-state.

2. The function of 'value guardian in defense of cultural pluralism': nonmarket private initiative contributes to the maintenance of cultural pluralism in the performance of public tasks, resulting in the survival of different social, cultural and political denominations in the nation-state.

3. The function of 'vanguard or service pioneer': nonmarket private initiative is mostly suited to fulfil a pioneering role in starting the provision of goods and services, for which market incentives or political incentives are insufficient to stimulate supply.

4. The function of 'countervailing power against government and state': nonmarket private initiative can play a useful role in following critically the functioning of government institutions in specific policy fields, and offer political oppose against an almighty state power and/or abuse of this state power.

5. The function of 'service provider': nonmarket private initiative may offer a higher quality of services for a lower price (efficiency advantages) and may be more responsive towards consumer preferences for public goods (effectiveness advantages) than pure government organisations.

The second and fifth argument have their equivalents in welfare economics. If consumer preferences for specific goods and services are homogeneous, market failures may be employed as arguments for public provision of these goods. Because of the condition, that citizens share the same preferences, government organisations are well equipped to provide these goods outside the market, by budget devices. Every consumer can be identified, his preferences can be determined, and the supply of goods and services can be matched perfectly with his preferences.

Things are completely different in case of heterogeneous consumer preferences for goods and services. If consumers have different preferences for goods and services which can not be provided efficiently by the market mechanism, the budget mechanism is much less equipped to discover the distinctions between these consumer preferences. Government lacks adequate instruments to make subtle distinctions between various groups of consumers; hence consumers cannot be served adequately. The supply of public goods and services cannot be matched with the specific preferences of consumers. Nonmarket institutions of private initiative dispose of much better instruments to reveal the specific


12. For a more extensive treatment of the distinction between homogeneous and heterogeneous consumer preferences and its consequences for adequate responses in the supply of goods and services, we refer to Boorsma and Van Mierlo (1992: pp. 149-180).
preferences of their clients, for instance on basis of the first and the second argument mentioned above (their functions of 'experimental garden of political democracy', and of 'value guardian in defense of cultural pluralism'). Due to the fact that they take a much closer position to their clients than government to its citizens, they are much more suited to discover the varying preferences of consumers and to respond adequately in their supply of public goods and services.

In addition, high quality service provision often is featured by technical heterogeneity at the supply side. Not only it is often the case that the one group of consumers does not resemble the other group of consumers at the demand side; also, the one group of services does not resemble the other group of services at the supply side. Technical heterogeneity appears to be present in the provision of public goods in many highly developed policy fields, such as education, health care, housing, social welfare, and so on. In this double heterogeneity of consumer preferences and of the characteristics of the provision lies a sixth, more economic argument for the performance of public tasks by nonmarket institutions of private initiative. This sixth argument has not been mentioned above.

Against these six advantages, which can be employed as arguments in favour of the performance of public tasks by nonmarket institutions of private initiative, disadvantages can be emphasised which in turn can be employed as arguments contra the performance of public tasks by these institutions.  

1. The expansion of the semi-public sector has resulted in a less efficient and very fragmented organisational structure in the performance of public tasks, causing increasing costs of public provision.  
2. The complicated and fragmented organisational structure of the semi-public sector causes problems of political control: external control on nonmarket institutions by political-administrative institutions of representative democracy, as well as internal control by the administrative bodies of the institutions themselves, are impeded as institutional complexity and fragmentation increase.  
3. The protection of the clients against the arbitrary behaviour of nonmarket institutions of private initiative performing public tasks is important but is not guaranteed. The threat of inappropriate protection of clients' rights increases with the growing problem of external and internal control.  
4. Finally, there is a growing risk that clients have to direct themselves to monopolistic institutions in receiving the public services they prefer. This risk increases as the nonmarket institution of private initiative becomes a monopolist in its service territory.  

13. See for a brief overview of these disadvantages, which became apparent in the historical development of the Dutch welfare state after the Second World War, Van Wersch (1980: pp. 71-80).  
14. This is the counterpart of the realisation of scale economies by administrative scale increase. Instead, scale economies are given up, in exchange for the alleged benefits of pillarisation. Forgone economies of scale are in the specific situation of the Netherlands known as the 'costs of pillarisation'. In a pillarised political system, every population group has its own institutional arrangements of public provision of goods and services. See for the Netherlands the study of Koelman (1987) on the costs of pillarisation in education, and for Belgium the study of Beeckmans (1985; 1987) on the costs of pillarisation in health care.  
15. In case of monopoly, clients only have the possibility to 'vote with the feet'. If they want the public services rendered they prefer, they have to direct themselves towards an institution outside the
The political decision to assign the performance of public tasks to nonmarket institutions of private initiative instead of to pure government organisations, implies a political evaluation of arguments pro and arguments contra both institutional arrangements. This evaluation has to be undertaken under the assumption that the goods and services in question cannot be assigned to the market mechanism because of important market failures (see Wolfson, 1988: pp. 31-51). In both cases, the performance of public tasks by pure government organisations or by nonmarket institutions of private initiative, decisions on production and consumption are coordinated (completely or partly) by the budget mechanism and not by the price mechanism.

3.2 Changing functions in the era of depillarisation

Starting in the seventies, nonmarket institutions of private initiative in the Netherlands have been subjected to processes of professionalisation and of 'statisisation'. Their performance of public tasks has been professionalised and the financing of this performance has been taken over almost completely by the state through a complicated system of government subsidies.

The resulting financial dependence of these institutions of the government ultimately implies a fundamental threat for their political autonomy. The organisation of new initiatives are only possible when the government provides financial means for this purpose, or when individual clients are willing to provide these financial means out of their own contributions. In fact, these new initiatives originate in the eighties mainly from the alternative circuit (sufficient manpower) and from the commercial business sector (sufficient financial means). Consequently, the traditional and established nonmarket institutions of private initiative do not longer fulfil their vanguard or pioneer function adequately.

In contrast, the countervailing power function of these institutions has gained considerable significance, due to the increased government interference with the semi-public system of nonmarket institutions. However, the central question in 1993 is, whether the 'statisisation' of these institutions has not made too much progress to fulfil this countervailing power function satisfactorily. Or, in other words, how much political autonomy has remained for an adequate countervailing power function? Should this statisation be considered to be a problem, or rather a facility for this function?

In this respect it is remarkable, that so many nonmarket institutions of private initiative in the nineteen eighties are played out of the political-administrative game by the Dutch government in the transition of the (neo-)corporatist model of political decision-making to a more 'etatist' model (see Van Mierlo, 1988: pp. 144-154). For example: advisory councils, in which umbrella organisations of nonmarket service territory of the monopolist. However, this possibility to receive the public services citizens prefer from public service institutions outside their own territory, is forbidden legally, as has been the case until recently in the Netherlands in the field of social health insurances. Ultimately, citizens have no choice left than to move their residence to the region which offers the public services they prefer. This is the essence of the theory of Tiebout (1956), mentioned in the introduction of this paper. See also Van Mierlo (1985).
institutions of private initiative take important positions, are passed frequently in the preparation of new public policies. At best, their advises appear to be taken for granted by the Dutch government.\textsuperscript{16}

As an inevitable result of these developments, nonmarket institutions of private initiative seem to be thrown back more than ever before to their classical function of \textit{service organisation}. An institution offering its clients public services of a higher quality at a lower price, can play an important role in the satisfaction of consumer preferences, against which government or market firms hardly can compete. By improving their classical function of 'public service provider', these institutions probably will be able to prove their right to exist in the future of the new Millennium.\textsuperscript{17}

\textbf{4. Functional organisations and institutional variety in the public sector}

Which conclusions can be formulated from our theoretical-historical analysis in the previous sections of this paper, and how could we evaluate these conclusions? Firstly, we draw some general conclusions about the potential contribution of the functional organisation principle to the realisation of institutional variety in the public sector, Secondly, we discuss briefly some new horizontal organisational devices in the public sector from the perspective of these general conclusions.

\textbf{4.1 The potential value of the functional organisation principle}

The neo-institutional approach to classical government organisations in the pure public sector and to nonmarket institutions of private initiative in the semi-public sector can build a theoretical foundation for the functional organisation of the public sector in a broad sense. This approach results in a plea for functional differentiation of pure government organisations, in addition to the classical territorial differentiation which has dominated the organisation of Dutch government since the liberal statesman and constitutional reformer Thorbecke (about 1850). Functional differentiation will lead to the creation of many more horizontal, coordinated organisations, which function as 'task organisations' (and not as geographic corporations) performing within their territorial jurisdiction just one central public task. Examples of this functional type of public organisations are the various independent public authorities ('schappen' in Dutch) which are familiar in the Netherlands in the policy fields of: quantitative and qualitative water management, agriculture, harbours, industrial sites, environmental protection, and so on.

Territorial differentiation has produced many vertical, hierarchically subordinated, public organisations, which function as geographic corporations performing a broad package of public tasks.

\textsuperscript{16} For a welfare economic analysis of the functioning of advisory councils in the Dutch health care system we refer to Van Mierlo (1987). The hypotheses which have been formulated in this analysis, are confirmed by the results of empirical research on some selected advisory councils in the health care system by Lapré (1986; 1987). See also Fortuyn (1990).

\textsuperscript{17} See the theory of ‘organisational death’ of institutions under the threat of a two frontier-war against on the one hand government and on the other hand business, as explained by Baakman (1989: pp. 35-51).
within their territorial jurisdiction. When the political dominance of thinking in terms of territorial decentralisation could be put to an end, and could be combined with various forms of functional decentralisation, a much larger institutional multiformity of the public sector in the Netherlands could be established. The result would not be more of the same: a mono-centric government with uncontrollable power concentrations, but a poly-centric government with a diffusion of power. Such a poly-centric government with build in mutual 'checks and balances', offers more possibilities for the exertion of effective political control by the individual citizens. In this way, institutional variety can be constituted in the public sector and will no longer be limited to the private market sector.

In addition, the neo-institutional approach reveals the weaknesses of the political strive for administrative scale increase in the public sector: 'small is beautiful' is not only a valid statement in the private market sector, where the coordination and other organisation costs of scale increase are discovered much earlier than in the public sector, but also deserves more attention in public organisations.¹⁸

A neo-institutional analysis of nonmarket institutions of private initiative in the Netherlands also makes clear, that the functional organisation principle dominates in the not for profit, semi-public sector. These institutions originated in the era of pillarisation in the Netherlands (1920-1970). They survived the turbulent decades of cultural depillarisation in the nineteen seventies. Increasing institutional depillarisation in the nineteen eighties brings the threat of a two frontier-war between an ambiguous government (simultaneous rapprochement and distance) and a penetrating private business sector nearer. A renewed emphasis on the functionality of nonmarket institutions of private initiative offers a sufficient perspective on the survival of these institutions.

The gap between both subsystems of the public sector in a broad sense (see Figure 2 above), the classical pure public sector in an narrow sense, and the (neo-corporatist) semi-public sector, probably can be bridged institutionally by the functional principle of organisation. The concept of 'independent administrative bodies' (in Dutch: 'zelfstandige bestuursorganen') offers a useful administrative specification of this functional organisation principle.¹⁹ Moreover, a connection can be made between the political theory of the democratic-socialists, in which the principle of functional decentralisation of the public sector played an important role before World War II, but nowadays seems almost completely forgotten, and the christian-democratic principles of 'sovereignty in the own pillar' (protestant) and 'subsidiarity' (catholic), on which the nonmarket institutions of private institutions originally were based.

¹⁸. See in this respect the publication of Van der Krogt and others (1987). Processes of scale increase on the level of the European Community make the discussion on the pros and cons of scale increase in the public sector in the Netherlands even more relevant and more urgent. Scale increase at the European level, however, has been left out of consideration in this article.

¹⁹. For the conceptualisation of this idea in the Netherlands we refer to Scheltema (1974).

²⁰. The first postwar social-democratic leader Van der Goes van Naters received his Ph.D. on a thesis on this principle in the nineteen thirties!
4.2 New horizontal organisational devices in the public sector

What does this conclusion imply for new horizontal organisational devices in the public sector? This neo-institutional analysis throws an new light on various forms of privatisation, such as contracting out public activities, more independency for public organisations, and even the complete finishing of public activities. Toonen (1988: p. 120) has formulated an answer to this question. In his opinion, privatisation is just one of the possible operationalisations of the more general concept of ‘administrative pluralism’. This specification refers to Ostrom and Ostrom (1977: p. 18). They already stated that the relations between collective consumption-units and production-units (governments acting as representatives of citizens-consumers of public goods and services, and as providers of these goods and services) could be formalised in various ways. A particular distinction should be made between the physical production of public goods on the one hand, and the provision of these goods to citizens-consumers on the other hand.\(^{21}\) Besides (local) governments assigning the production of goods and services they provide publicly to their (local) citizens-consumers, to their own public organisations and institutions, or contracting out this production to (local) business firms in the (local) market sector, many other institutional arrangements for public provision at the local level can be constructed.

1. Municipalities which make use of public provisions in other municipalities, at the same level of the state. These other municipalities deliver paid services, but also may be confronted with free ridership activities of individual citizens.
2. Public organisations which make use of the services of other public organisations, at a higher or a lower state level. This may result in various systems of co-governance, but also in paid services of central government or provinces to municipalities.
3. Municipalities which act as consumption unit and ask delivery of public services from specific producers, by employment of quality standards through a system of permits. Citizen-consumers are free to choose between competing producers. Examples are: central taxi distribution units, lawyer services, cable television, telephone companies for ‘long distance-calls’, private civil protection organisations).
4. Public organisations which combine demand for and finance of specific public services and distribute vouchers or tickets to citizen-consumers who can buy these services themselves from authorised production-units. Examples are: educational services and health care services.
5. Different consumption units which form a combination to establish an independent production-unit. Examples are: regional energy enterprises, regional police bodies, schools for vocational training in public administration, regional fire brigades, other forms of inter-municipal cooperation, independent administrative authorities.

\(^{21}\) This distinction between ‘public production’ and ‘public provision’ already has been made by Musgrave in his monumental publication on public economics of 1959, on analytical grounds. Physical production of public goods can be undertaken by business firms in the market, whereas their actual provision through the budget mechanism makes them public. Musgrave emphasises that the provision (market versus budget), not the technical characteristics (individual versus collective), makes specific goods to public or private goods.
6. Municipalities, provinces and departments/ministries of the central government which for specific parts of public services (police, fire brigade, utilities, environmental protection and health care) make use of mixed combinations of all possible organisational structures (combining arrangements 1 to 5 listed above).

All these alternative institutional arrangements fit into the broad scala of various possibilities of privatisation of public services, varying from internal decentralisation within the public organisation on the one hand (functional organisation forms in the pure public sector), to the creation of external organisations on the other hand (in the semi-public sector: nonmarket institutions of private initiative, or in the private market sector: commercial business organisations and firms).

5. Conclusion

In the neo-institutional approach (of which Ostrom and Ostrom in the United States of America, and Toonen in the Netherlands, are strong proponents), the organisation of the public sector is presented as a complex administrative system. This system is the result of a complicated political process of mutual relationships and adaptations, cooperation and negotiations between a large number of separate, relatively independent administrative units. The organisation of the public sector is not a matter of developing a blueprint of the perfect and ideal distribution of tasks and powers over various administrative units, which can be forced upon public organisations by a central organisation in the political system. From a perspective of organisational economics this statement can be reformulated as follows: the organisation of the public sector and of government cannot be judged by standards derived from the rational-synoptic model, but only by comparing relative advantages (benefits) and disadvantages (costs) of different institutional arrangements for public provision of goods and services, as they occur in empirical reality and in real life circumstances. In the words of Ostrom (1973: p. 132):

"A democratic theory of administration will not be preoccupied with simplicity, neatness, and symmetry, but with diversity, variety, and responsiveness to the preferences of constituents. A system of democratic administration depends upon an ordered complexity in social relations."

In the Netherlands, in particular local governments (i.e. the municipalities) have realised this fundamental concept in everyday practice of the organisation of their local public sectors. Various local privatisation operations produce good examples for privatisation operations of public services on the level of central government. From a democratic point of view, not the preferences of public producers and providers, but the preferences of citizens-consumers should count in the political decision-making process on public provision. The examples of local governments in the Netherlands deserve more attention, and perhaps even imitation at the central level of government.

Moreover, the neo-institutionalist theory of poly-centrism, developed in the United States of America, and practised in its federal political system, may serve as an important source of inspiration for institutional reform of the public sector not only in the Netherlands, but also at the level of the European Union. This might contribute to the Federalism-debate in the European Union. Furthermore, lessons can be
learned from this approach by CEE-countries applying for membership of the European Union, because it can give guidance to the necessary processes of social transformation, institution building and establishing good governance.

Briefly summarised, the following alternative institutional arrangements have been developed in the Western countries and they may be considered also for application (after adaptation to specific country circumstances and characteristics!) in CEE-countries with their economies in transition.

1. Municipalities could be service supplier to other municipalities in some cases, but in other cases they could be service demander, depending on the specific characteristics of the service in question. In this way, comparative advantages will lead to horizontal differentiation and specialisation among local service suppliers.

2. Municipalities could also demand services supplied by public organisations either on a higher or on a lower state level. This may result in forms of vertical co-governance, but also in paid services.

3. Municipalities which act as consumption unit and ask delivery of public services from specific private producers, by employment of quality standards through a system of permits. Citizen-consumers are free to choose between competing producers. This can be practised in telecommunication industries.

4. Public organisations which combine demand for and finance of specific public services and distribute vouchers or tickets to citizen-consumers who can buy these services themselves from authorised production-units. Examples are educational services and health care services.

5. Different consumption units which form a combination to establish an independent production-unit. This production-unit takes the form of functional (and not territorial) government.

6. Municipalities, provinces and departments/ministries of the central government which for specific parts of public services (police, fire brigade, utilities, environmental protection and health care) make use of mixed combinations of all possible organisational structures (combining all the arrangements 1 to 5 listed above).
References


