

## What Do Bureaucrats Maximize?

Economics of Public Policy  
PADM 625  
Fall, 2004

## What do bureaucrats maximize?

- Economists assume that:
  - Consumers maximize utility or satisfaction
  - Firms maximize profits.
- What do bureaucrats maximize?
- William Niskanen argued that it is useful to assume that they act purposefully to maximize the budgets of their agencies.

## A bureau is:

- "...any nonprofit organization financed by an appropriation or grant, rather than revenue from sales..."
- A "bureau" can't earn a profit, so the personal goals of the managers and employees are its main concern...

## These goals might include:

- "higher salaries for employees, perquisites and amenities, prestige, power, and the potential for advancement and promotion..."
- Also, the public good – as defined by the employees: for example, persons employed by a transportation department may define it in terms of highways – to the exclusion of other (perhaps environmental) goods

## These things

- Are associated with larger departments and budgets
- Thus, Niskanen argues that bureaucrats tend to define success in terms of these things

## He said,

- "The rationality of budget maximization by bureaucrats may best be illustrated by considering the consequences of contrary behavior. Consider the probable consequences for a subordinate manager who proves without question that the same output could be produced at, say, one-half the present expenditure..."

### He said,

- “In a profit-seeking firm this manager would probably receive a bonus, a promotion, and an opportunity to find another such economy; if such rewards are not forthcoming in a specific firm, this manager usually has the opportunity to market his skills in another firm...

### He said,

- “In a bureau, at best, this manager might receive a citation and a savings bond, a lateral transfer, the enmity of his former colleagues, and the suspicion of his new colleagues. Those bureaucrats who doubt this proposition and who have good private employment alternatives should test it...once.”

### Model features

- “bilateral monopoly between legislative committees and agencies”
- Agency monopoly over provision of services
- Agency presents legislature with a “take-it-or-leave-it” budget request
- Agency has control over “reversion budget”

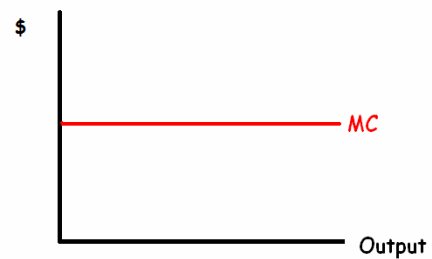
### Model features

- Reversion budget: agency presents legislature with its preferred budget, and there is an alternative “reversion budget” that will be adopted if the agency’s budget is not.
- Agency seeks to increase its size and in its budget

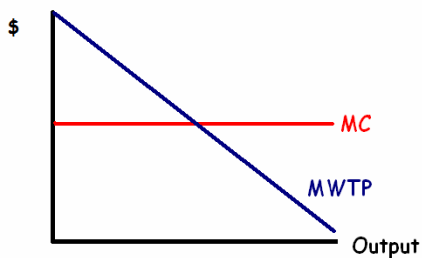
### The axes



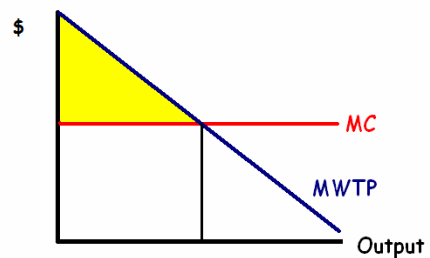
### Marginal costs:



### Add a MWTP curve:



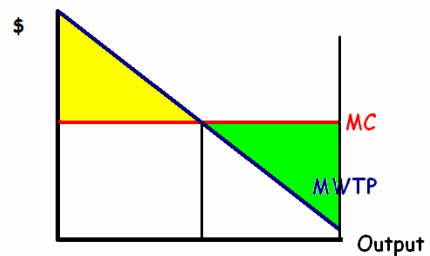
### Maximizing consumer surplus:



### Suppose

- Agency could present legislatures with a choice
- Either no services, or a set of services that provides a small net benefit to the voters?
- Legislature would be better off taking the set that just provides a small net benefit to the voters
- The "no services" outcome is called the "reversion" outcome

### Not maximizing consumer surplus:



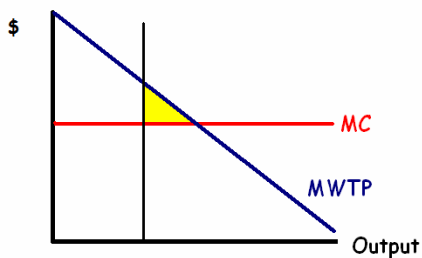
### Agency can:

- In the extreme case, if the reversion budget is zero, so that there is no good provided,
- The agency could offer an alternative far enough beyond the optimum to almost completely use up the consumer surplus created.

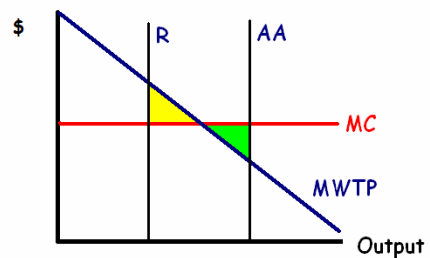
### In a less extreme case:

- Reversion budget is probably not so extreme
- But if it is below the public's optimum point, agency's will have power to expand budget
- And agencies do have power over reversion budgets – evidence that an agency forced to cut back often cuts back what the public likes best

Suppose this is the reversion budget?



Agency might offer this as an alternative:



Where would bureaucratic power come from?

- Output of a government department is hard to measure
- “Asymmetric information”
- Managers have better information about the output of a government department than the politicians
- The principal-agent problem (an important issue in corporate governance)

What Niskanen’s model highlights:

- Raises the question – what are the motives of bureaucrats? Bureaucrats as active agents with a wide range of motives – more like people outside of bureaus
- Raises the question of asymmetric information, and the related issue of the principal-agent problem

Science moves on

- Niskanen’s model was very influential
- And is still “in play”
- But not as influential as it once was
- One reason: assumes a very passive legislature
- Legislature in a position to establish the rules of the game – to behave strategically – agencies are the legal creatures of the legislature

Sources

- Bruce
- Stevens, Joe B. *The Economics of Collective Action* pgs 269-278.
- Moe, Terry. “Positive Theory of Public Bureaucracy” in Mueller, *Perspectives on Public Choice*.