

# PUBLIC POLICY IN CENTRAL AND EASTERN EUROPE:

**THEORIES,  
METHODS,  
PRACTICES**

**EDITORS:**

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**NISPAcee**

THE NETWORK OF INSTITUTES AND  
SCHOOLS OF PUBLIC ADMINISTRATION  
IN CENTRAL AND EASTERN EUROPE



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The Network of Institutes and Schools of Public Administration in  
Central and Eastern Europe

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**Editors:**

**Martin Potůček, Lance T. LeLoup, György Jenei, and László Váradi**

This book was sponsored by a grant from The Pew Charitable Trusts, and with support from the National Association of Schools of Public Affairs and Administration (NASPAA)

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(The Network of Institutes and Schools of Public Administration in Central and Eastern Europe)

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Printed in Slovakia  
ISBN 80-89013-13-9

NISPAcee is an international association focused on the public administration and its mission is to foster the development of public administration disciplines and training programmes in post-Communist countries, increase the quality of instruction and research and assist its member institutions development at both international and national levels.

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## Preface

*György Jenei, Lance T. LeLoup, and Martin Potůček* \*

*Public policy.* A couple of words that are the antithesis of political practices of communist times. It is no wonder that by the start of the 1990s this word had started to be used in part for the labeling of specific social practice, and in part for describing a scientific field of activity.

The drama of the birth of public policy as a social practice is being played out before our very eyes. Why drama? Well, if we start with Ralf Dahrendorf's description of the transition from an authoritarian regime with a centrally-planned economy to a democratic society with a market economy, one can assume that political institutions can be changed in six months, economic relations in six years, while peoples' habits, attitudes, behavior and values need sixty years to be transformed. This discrepancy creates innumerable tensions and crises of development of varying magnitude. If we want to understand their character, then the disparate pieces of information comprising public policy theory that have been assembled in the course of contemporary capitalist society's relatively peaceful evolution will not suffice. We are forced to look for approaches appropriate to the specific situation in which those countries of Central and Eastern Europe undergoing transformation find themselves.

One remarkable and hitherto not clearly defined characteristic of communist regimes was their success at blurring the borders between the individual and functional wholes of the societal organism. It was thus unclear where the responsibilities of, on the one hand, parents and, on the other, the state began and ended regarding the upbringing and education of children. Within various policies and processes, procedures fused social and economic criteria, and the state apparatus and party organs forged themselves into a single hybrid decision-making structure.

The destruction of the boundary between the public and private spheres was on its own a vivid testament to the "fogginess" of the world of "real existing socialism". Private ownership was nationalized. The reality of formal state ownership was that it became the booty of the incumbent administrators, later managers. The private sphere was passed off as the legitimate subject of interest of, and where necessary also of surveillance and intervention of those who ruled. Issues that touched the everyday lives and interests of the public were again dealt with behind the closed doors of the secretariats.

One of the basic tasks of politics since 1989 has thus been to adjust societal institutions (and, where necessary, create new ones) to their new economic and societal context, as well as the optimizing of their regulatory influence and functional

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connectivity. This change occurred particularly in the course of the reconstitution of the borderlines between the private and public sectors.

To this point we have only mentioned the situation specific to Central and Eastern Europe (CEE) after 1989. However, social practice has, in one form or another, postulated a similar challenge to social theory in other countries of the world – far earlier than here, in fact. This has been connected to a number of evolutionary tendencies that the more developed part of the world has experienced in the course of the twentieth century. One of these tendencies, perhaps the most important, was, and is, the growth of the public sector both in an absolute as well as a relative sense. A further sign of this has been the noticeable differentiation of activities taking place within this sector and changing modes of its interconnections with the private sector; the enormous changes that have occurred in education and healthcare provision over the last fifty years, for example. A third characteristic has been the growing importance of expertise dealing with the conception and realization of various specialized activities connected with satisfying public needs.

Public Policy is a relatively new orientation, described with a variety of terms: policy sciences, policy studies or policy analysis. The very essence of these terms is that they refer to an applied science concerned mainly with the public affairs. As early as 1951, American political scientist Harold Lasswell, wrote about “The Policy Orientation.” By the 1960’s, the study of public policy was providing a new approach to the problems of government. The main focus of this orientation is to find out, in Thomas Dye’s words (1976) “what governments do, why they do it, and what difference it makes.”

The first academicians dealing with the causes and consequences of government actions were political scientists. There was a growing need in the government for social, economic and political sciences in a search for relevant explanations – with the application of traditional legal and managerial knowledge – for the solution of the problems in the public sphere.

Some scholars came to the conclusion that the content and the timing of political decisions were significantly influenced by civil servants. Public administration and students of bureaucracy became involved in the study of public policy. They were motivated to better understand the decisions and actions of public agencies in order to improve the quality of public policy.

The public policy approach soon became multidisciplinary with the application of economics, sociology and psychology as well. Political scientist Aaron Wildavsky (1979) offered the perspective of a policy analyst as a craftsman, learning incrementally from experience, dealing with the failures and difficulties of public programs, strongly motivated “to understand what went wrong and to learn how things might be made to work better.”

Public bureaucracies in Central and Eastern Europe face many different pressures and challenges. Many people are losing confidence in public institutions, which themselves face pressures on their resources and budgets, because their



existing commitments collide with new demands. Meanwhile there are calls for more 'direct democracy' and more opportunities for participation. These trends are accompanied by decreasing respect for the traditional instruments of 'representative democracy'.

The traditional civil service was established to run in a stable and predictable way, in a relatively static environment. This meant it was not prepared and was resistant to change. Today's civil service, on the other hand, has to adjust and accommodate to a rapidly and sometimes unpredictably changing environment. Civil servants need managerial skills. They must not be inward-looking or averse to risk-taking. At the same time, the civil service needs to recognize political realities and be able to participate not only in the implementation of decisions but in policy-making.

In the Central and Eastern European countries, this has to be done while democratization continues. Far-reaching changes occur in government while the market economy establishes itself. The civil service should be professionally expert and at the same time transparent and democratically accountable.

Public Policy orientation is a special challenge for CEE countries vis-a-vis European Union membership. As part of the accession process, governments must change adapt their laws to those of the EU following administrative principles of reliability and predictability, openness and transparency, accountability, efficiency and effectiveness. Successful accession and membership in the EU will be facilitated as the policy orientation is strengthened in both formulation and implementation.

This volume represents the collaborative work of social scientists in CEE with the assistance of several American colleagues to map out the emerging world of public policy analysis since the economic and political transition. The articles encompass a range of topics: approaches to public policy, various theories of public policy, the role of the state and bureaucracies, ethics, the public interest, the policy process, coordination, non-profit actors, budgeting, implementation, and substantive policies of education, health care, and social policy. The approaches are interdisciplinary and multidisciplinary. The chapters benefited from two authors' conferences that took place in Prague and Budapest in the late 1990s as the contributors shared ideas and gained insights from others. The result is a unique perspective from Central and Eastern Europe that we hope will have value for the region as well as those around the world.



# Chapter 1



# Approaches to Public Policy in Central and Eastern Europe

*Martin Potůček and Lance T. LeLoup*

## 1. Introduction and Overview

As a relatively new field of inquiry, studies of public policy are multidisciplinary with less clearly defined boundaries than other disciplines. Policy analysis around the world is still searching for a clear identity and that remains true in Central and Eastern Europe (CEE). Agreement does not exist on a precise definition of public policy or policy studies. Peters defines public policy as “the sum of government activities, directly or indirectly affecting citizens”, operating at three levels: policy choices, policy outputs, and policy impacts (1993: 4). Dunn suggests that policy analysis is “an applied social science discipline which uses multi-disciplinary methods of inquiry and argument to produce and transform policy-relevant information that may be used in political settings to resolve public policy problems (1981: 35). In the introduction to the *Encyclopedia of Policy Studies*, Nagel defines policy studies as “the study of the nature, causes, and effects of alternate public policies” (1994: xi).

Some cast a wider net than actions by the government to remedy problems. In his influential works, Charles Lindblom suggests that government actors are largely “functionaries”: “Public policies are made via a complex political system and cannot be understood primarily by looking at the actions of ...top government officials” (1993: 3). Public policy, he argues, is better seen as the product of broader social forces, particularly the dominant position of business in capitalist democracies and is restricted by limits in human capacities. He also emphasizes the conflict between reasoned judgement and political power. In addition, Lindblom criticizes the tendency of many of the studies of the policy process to characterize policymaking as a sequential process, proceeding from agenda-setting to formulation to enactment to implementation to impact and evaluation.

While few will deny the importance of business and other societal forces, and the limits of human capacities and policy analysis, Lindblom’s definitions are so broad that it is difficult to make conceptual choices, particularly when trying to develop policy studies in a new context, such as CEE. Similarly, other overly-broad conceptualizations, such as John Kingdon’s (1984) characterization of the policy process as a “primeval soup” with no beginning and no end, make it difficult to make progress as a field of study.

Public policy emerged in the 1960s, encompassing political science, sociology, economics and other disciplines. The Policy Studies Organization was formed in 1971 in the U.S. and was open to scholars of other nations. Policy studies emerged out of a greater concern for specific policy problems, the causal determinants of particular policies, and the relationship between policies and societal effects. Policy

studies seek to understand what nations do, not just how they do it. They link process to results and put more emphasis on impacts, systematic evaluation of results, and unintended consequences.

Despite the disputes over definitions and defining the parameters of the field, some characteristics can be agreed upon. In particular, these are its interdisciplinary nature and the importance of its applied dimensions. Policy studies take elements from many disciplines:

- Political science: emphasis on the process by which policy decisions are made
- Public administration: emphasis on the role of bureaucracy in shaping policy and implementing decisions
- Economics: emphasis on concepts such as instrumental rationality, cost/benefits, maximization, and specific economic policies
- Sociology: emphasis on class, status, and social problems
- Philosophy: emphasis on logic, values, and ethics.

The list could be extended to include broader perspectives of history and the policy lessons of the past, anthropology and the importance of culture, law mathematics and the tools of measurement and analysis, and the natural science in terms of specific policies in health, energy, and ecology. The interdisciplinary nature of policy studies can be both an asset and a liability. While it transcends the often overly narrow restrictions of a single discipline and invites a range of perspectives and knowledge, the lack of boundaries and parameters can be a source of confusion and lack of clarity in developing research and a curriculum in the field.

The second key characteristic of public policy is its applied dimensions and relevance, direct or indirect, to real policy problems facing society. This desire for relevance, to provide information that ultimately would help better solve public problems, was a crucial factor in the emergence of the field. Yet this dimension, too, can serve as both a strength and weakness. Its relevance adds immediacy and significance to research findings and appeal to scholars and students with positive goals for improving society. Conversely, its applied nature can contribute to weaknesses in underlying theory and its perception by other fields that research often lacks scientific merit. This perception is enhanced by the misuses and politicization of policy analysis and its use as an advocacy tool. This has been fostered by research from so-called “think tanks” with a highly ideological bias.

All of this is relevant for the question of the development of public policy as a field in CEE after the political and economic transition. In this chapter, we will look more closely at the disciplinary bases of public policy studies. In the conclusion, we consider the question of applied research versus theorizing at a higher level of abstraction that may seem of less relevance to everyday policy problems.

Attempting to characterize a sphere of scientific activity is never too popular among the experts within that particular field. The reasons for this are understandable. Because of the enormous accumulation of knowledge, of paradigmatic and methodological innovations, and the strengthening of the problem-solving

and thematic orientation of science, the traditional boundary between disciplines is becoming yet more imprecise. Many, though not all would add that it is also becoming ever less functional. We will thus attempt to define public policy as a scientific discipline by referring to those concepts, terms and disciplines which like the fates, presided over its birth. We will also consider the specific cognitive problems that public policy resolves.

Within its conceptual terminology, public policy contains a number of expressions whose common descriptive element is the word “public”. Included in this are terms such as public interest, public sector, public finance, public property and public law. The concept of public interest is used particularly in the fields of sociology and political science, the terms public sector, public finance and public property belong to the realm of economics, while the term public law is used in legal science.

## **Sociology, Political Science and Public Policy**

### *The Public Interest*

The very first concept, that of the public interest, is controversial. One must add that it is not generally accepted. We will therefore start with a classic description given by the Nestor of American political science, Lippman (1955: 42):

*“It is given to be believed that adults share common public interests. However, they often confuse the public interest, and it sometimes conflicts with their private and particular interests. If this is so, it can be said that the public interest is obviously that which people would choose if they saw clearly, rationally, acted benevolently and without bias.”*

The term public interest undoubtedly has a descriptive power, but it is also value loaded. As Lane (1993) observed, there still exists a tension between the individualistic connotation of the term “public” and the overall relative connotation of the term “public”. The public interest can be that which the majority in a democratic society desires. But do we not by this infringe upon the rights of minorities? In any case, there is the community, civil society and the state, which, through these institutions, offer institutional mechanisms for the articulation, aggregation and coordination, and in some cases even the realization of sectional interests into a form whereby we can already begin to talk about “public interests”. The complication provided by the institutional “mediation” of these public interests is of course also relevant. Authorities and officials also have their own interests which they insert into the political process aims to identify and satisfy that thing known as the “public interest”.

A specific definition of what is (or what ought to be) a public interest is thus a living, never-ending social and political process which in a democratic society conforms to certain rules governing the discourse concerning what is a public

interest and what not longer is, how to agree on such a definition and how to apply and protect the public interest in practical terms.

We are inclined to hold the opinion, that public interests find expression in a particular type of political orientation (and, should they be sufficiently informed, in the people themselves), which supports the development of the community and the resolving of its problems. In this sense, these are the interests of the individuals who belong to that community. Nevertheless these interests can also act against those individuals or groups who have opposing interests. Public interests thus often become the focus of negotiations and occasionally even conflict. At this point we step into the realm of public policy that deals with the identification, formulation, presentation, acceptance and implementation of public interests.

As a background to their comparison of eight countries, Wilensky and Turner (1987) empirically tested the hypothesis of whether corporatist democracies – i. e. societies where classical mechanisms of representative democracies both competently reflect somewhat superficially expressed public interests, and which also complement many other interconnecting linkages that behave as agents for negotiations between political partners (tripartite, professional and economic chambers, civil associations etc.) – are capable of more effectively directing these classical mechanisms across articulated group interests so as to satisfy public interests. Public interests were defined as economic prosperity, employment and the maintenance of income levels. The result of the comparison confirmed the validity of the proposed hypothesis.

Understandably, there also exist conflicts between various “public interests”, whether between those already connected with various communities or social groups, or with those competing value orientations, these groups visions of the world and their role within it. These conflicts create differences in basic values that underpin various public policies, and which even project themselves into theoretical models of public policies (see later chapters).

### *Political Science versus Public Policy*

Traditional political sciences tend to see the execution of a policy as a specialized activity, a division of the labor of professionalized human activity, directly connected with the representation and conflict of interests and the battle for power. At this level we can talk about policies that safeguard the existence and survival of relatively autonomous complete communities. Typically these include nation states, but also local communities and supranational associations. Public policy, on the other hand does not analyze to the same extent those general political conditions in which policies originate, nor the existence and survival of such social forms. Rather, it is interested in the social and political process leading towards the satisfying of those concrete, differentiated human needs held by communities and their members, whose needs cannot exclusively be satisfied by the private sphere.

In order that we can better illustrate these not immediately obvious differences between the terms of reference used by traditionally-orientated political sciences



and public policy, the concepts laid out in the following table should give a true picture of these variances. <sup>1</sup>

**Table 1-1**  
Semantic differential of variances between traditionally orientated political science and public policy

<b>POLITICAL SCIENCE</b>	<b>PUBLIC POLICY</b>
Ideology	Technology
Conflict	Consensus
Misappropriation of power	Service
Rule	Co-operation
Representation	Satisfying of needs
Short-term horizon of decision-making	Long-term horizon of decision-making

The transmission of these various policy differentials, as defined by political science, to the analysis of policy in the public sector have interesting theoretical implications:

*Reactive versus Proactive Public Policy*

- Proactive public policy attempts to anticipate the possible threats to, as well as the development opportunities available for the satisfying of public interests, and also tries to adequately react in advance to anticipated developments. Thus it acquires here the significance of forecasting as a set of methods to be used in the investigation and shaping of possible futures.
- Reactive public policy reacts as and when the public interest is actually threatened.

*Liberal versus Paternalistic Public Policies*

- Liberal public policy intervenes where an individual interest threatens the accepted public interest.
- Paternalistic public policy enforces the recognized public interest (in the case of an authoritarian state's public policy, there is a greater risk that the policy being imposed is in fact something that is merely passed off as a public interest) often without regard to detrimental impact of such policy on individual interests or on the changed (changing or differentiating) character of human needs and expectations.

<sup>1</sup> The method of semantic differential used has the advantage that it works with closely related definitions and associations that have a continuum defined by two polarized concepts. It is concerned more with a description of typical features, rather than the exact delineation of boundaries, corresponding to the relationship of both disciplines.

## **Economics and Public Policy**

A basic characteristic of public policy is that – in areas specified later – it concentrates on the analysis of how the public sector functions. The public sector is the antithesis of the private sector, where an individual (or company) decides for themselves on the nature of their private interests and on their execution. Decision-making occurs in the public sector that both involves and influences a number of individuals or institutions. It is here, that the public interest in, among other things, the production and distribution of public assets is formulated and asserted. Public economics is directed towards the economic aspect of its functioning while Public finance focuses on the principles and mechanisms of generation and the usage of public budgets.

What is the difference between the public and private sphere, between the public and private sector? This distinction manifests itself both in the differences between institutions and the interests which they follow, and in individual preferences. The basis of the private sector lies in the fact that individuals (or firms) decide for themselves on the nature and execution of their private interests. By contrast, it is in the public sector where decisions involving and influencing many individuals and / or institutions are made and where the public interest is predominantly formulated and realized. It is possible to compare the public sector to a household where resources produced by its members are accumulated. Inside the household, decision making also occurs on how these productive resources will be utilized.

Citizens, political institutions, the government and the bureaucracy occupy the public sector, while interacting individuals, producers and consumers, various non-profit and commercial institutions have come to occupy the private sector. Individuals, groups and elites often use the criterion of public interests for the resolution of problems in the public sector, while private interests prevail in the private sector.

It is commonly assumed that the system of public institutions contribute to the common good. Public institutions, as long as they function well, are without doubt just as important for the development of the state when viewed as an economic resource. The problem is, of course, that it isn't totally clear how these state institutions should look like and function in order for it to be possible to say that they function effectively from both an administrative or managerial viewpoint.

It is possible to ask the question as to whether there exist criteria by which we could specify the differences between the public and private sectors. One possible answer is to define the public sector as a kind of sector financed from state budgets. However, this criterion overlooks the regulatory role of the legislature. We can also associate the public sector with the political and legislative activities of the government (the state) and its consequences, and also with what the government provides to citizens (for example, various handouts and services, employment, state ownership). This delineation would, however, reduce the public sector to merely

a branch of state administration. Local government and the activities of civic associations that are of benefit to the public would be excluded.

The following table gives an outline of the criteria that should be taken into account when looking to answer the aforementioned question.

**Table 1-2**  
Criteria differentiating the public and private sector

Criterion ↓ \ Sector ⇔	Public Sector (public interests)	Private Sector (private interests)
Execution of power	Government	Individuals (humans, institutions)
Consumption and investment	Public consumption and investment	Private consumption and investment
Nature of decision making	Political or administrative decision	Private (personal or institutional) decision
Provision of goods (in cash & kind)	Public goods	Private goods
Ownership	Public ownership	Private ownership
Employment	In the public sector	In the private sector

The proposed criteria do not, of course, mean that concepts used in each sector are mutually exclusive. A large public sector can for example work with elements of free choice and competition, impose duties on the demand side, rent from the private sector in order to satisfy public interests. A whole range of other examples can be found:

- Non-profit organizations that orientate themselves towards meeting public interests, but which at the same time are part of the private sector and which in the market behave in a similar manner to rent/seeking actors. In order to reflect their importance, there will be an individual chapter devoted to these institutionalized forms in the following text.
- QUANGOs (quasi non-governmental organizations), formally non-governmental independent institutions, which in many respects, however, rely on governmental policy.
- Compulsory insurance combining the satisfaction of both public and private interests.
- State universities supported by private sources, and private universities jointly financed from public funds (a reflection of the current situation in the USA).
- The so-called “welfare mix” in numerous areas of social policy, where the provision of services mutually complement each other, and where institutions of the public and private sectors co-operate.

The boundary between the public and private sector changes both in time and between individual societies (cultures). For example, in the USA the private sector is much stronger than in Europe; Europeans are culturally and psychologically more prepared to expect, in a number of life-situations, assistance from various institutions of the public sector. The other side of the coin is a greater reserve held by Europeans towards privatization in areas “historically” considered as belonging to the public sector e. g. transport, telecommunications, prisons...

### **Law, Organizational Science, Public Administration and Public Policy**

Those efforts made at interpreting the complementary functioning of the market and government which do justice to the political dynamic of democratic societies with a functioning market economy are epistemologically very interesting. Government is perceived as non-market, political decision-making and its realization as taking advantage of the law, and democratic political institutions as acting as a conduit for the citizens’ and public interests. As a consequence, government is perceived both as an instrument regulating the behavior of societal actors and as an instrument fulfilling a regulatory function similar to that of the market, but by the use of alternative methods and with different objectives.<sup>2</sup> (As previously stated, an interesting new institutional form that, in order to achieve its objectives, ties in public interests with those conditions typical for the private sector are the non-profit organizations which constitute an independent civic sector.)

Already many decades before, authors such as Weber, Whyte, Drucker and others had begun to notice the growing significance of formal organizations in the lives of both people and global societies. These organizations – or, to use another term, bureaucracies – are a precondition and a consequence of the performance of the administrative function. Public policy must thus make use of the traditional terminologies used in organizational science, institutional sociology, public administration and other disciplines.

Public administration analyses the activities of those entities empowered in law (e. g. state offices, public bodies, local governments, judges), which, through their permitted activities and jurisdictions can be identified as the executors of public administration (Hendrych 1992: 10; modified). The difference between public policy (as a scientific discipline) and public administration is thus defined by the different subjects of their analyses, i. e. on the one hand, public policy as a practical activity, and on the other, public administration.

*“The life of any society can, at any moment, be split into two aspects: principally it is a series of communal events which in some fixed way always repeat themselves again and again; there are also those events, which are in a state of birth, where a decision that must take place in*

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<sup>2</sup> See future chapters of this book and publications by Lane (1993), Lindblom (1977) and Weimer-Vining (1992).

*an individual case can still be realized in new forms.” (Schäffle 1897, quoted in Mannheim 1991).*

Schäffle calls the first aspect of societal existence “everyday state life” (in our terminology, the administration – our remark), the second he calls policy. If everyday affairs thus organize themselves into everyday official life conforming to existing rules and regulations, it can be ranked under “the administration”. In the case of it being the creation of something new, where it is not possible to use any known algorithms of decision-making and implementation, we can then put this into the category of policy.

The difference between public policy and public administration (as practical activities) can be analogously characterized thus: public administration contains well-established, routinely repeated activities within the framework of preordained regulators, whereas public policy is the creation of something new, that goes beyond established practices of implementing the public interests.<sup>3</sup> In the same token, it would even be possible to distinguish differences in the cognitive scope and concepts of public policy and public administration (as sciences). In the following chapters, intensive attention will be devoted to the theoretical as well as practical significance of understanding the role of the market, government and the civic sector as important regulators of societal life as well as their mutual relationships.

### **Public Policy as a Scientific Discipline**

Public policy as a discipline can thus be defined as that which uses the terms of reference of sociology, political science, economics, law, organizational science, public administration and other disciplines for analyzing those processes of formulating and implementing differentiated public interests used to resolve specific problems connected with the life of human society. At the same time, it is devoted to the institutionalized management of these processes via the public, civic and to a certain degree the commercial sector in a form that can be used in political practice. Public policy is therefore a scientific discipline *sui generis* that cuts across many other scientific disciplines. It extends beyond the boundary of traditional social sciences in both its thematic structure and also in its cognitive scope and methods of investigation that it uses.

One of the key elements in characterizing public policy as a science concerns the tension between abstract development of theory and applied relevance. The more abstract theories are dismissed by some decision-makers as irrelevant to real world problems. Conversely, scholars dismiss some applied work for the opposite reason, that it does not contribute to the generalization and testing of theories. Prezyworski has written that the goal of comparative public policy analysis should be to substitute the names of variables for the names of countries (1971). That

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<sup>3</sup> The state administration (as a practical activity) is that part of public administration protected by the state and its institutions. Apart from this, public administration also comprises self-governing public bodies (municipalities etc.).

raises the issue of uniqueness concerning CEE. Is research from the West going to be relevant to the particular history and culture of the region? Higher level generalizations tend to minimize cultural and historical differences whereas more applied work more frequently takes those factors into account.

An example of public policy conceptualized at a high level of abstraction for theoretical purposes is Lowi's (1968) typology dividing policy into distributive, redistributive, and regulatory categories. With the dramatic changes taking place in CEE since the beginning of the 1990s in terms of developing legal frameworks and regulations, and the important distributive and redistributive consequences associated with economic policies and cutbacks in social policies, such a framework might satisfy the need for higher-level generalization and relevance.

Another framework designed specifically for CEE nations was suggested by Ivan Grdesic (1994). He suggested that the public policy agenda in the post-communist states is determined by the level (scope) and content of decisions. At the first level are questions of national identity and the nation's constitution. At this level, there occur also such agendas as the "choice of society" as embodied by the battle between Václav Havel and Václav Klaus about the future orientation of the Czech Republic (Potůček 1999). At the second level are rules, procedures, and other frameworks of the political and economic system. The third level, he suggests, entails the arena of political action and interest groups in society. He believes that first level differences are particularly important in setting the policy agenda in CEE countries.

The main problem with such approaches, whether applied to CEE nations or western nations, is that the high level of generalization makes them more of interest to scholars seeking theoretical development than to policymakers seeking immediate information and solutions to problems. At the other extreme, narrow country éand program – specific studies of a particular policy, such as the evaluation of a welfare program in Poland is likely to have less application to scientific theory building. What would tend to be more generally transferable are policy analysis methods and techniques. The methodologies of cost-benefit analysis, different kinds of program assessments, survey research and focus group techniques, forecasting and statistical methods are extremely relevant for policy studies in CEE as elsewhere.

This includes research on the effects and impact of policies. Although the specific cases may be less important, lessons learned abroad in measuring impacts, both intended and spillovers, are useful.

Also relevant to the development of a scientific study of public policy in CEE is the data necessary to use established policy research methodology, such as budget data and demographic trends, survey research and citizen satisfaction measures. Even if the substance is different, comparative policy research can help clarify desired capabilities in both information sources and analytical capacity.

Comparative policy research is also relevant to developing policy options, although they must be carefully grounded in the institutions and historical and

cultural context of each nation. This is not unusual in policy research, however. One of the important roles of the scientific study of public policy is to identify an array of options from the vast international menu that are within some reasonable boundaries of political feasibility. That is why we turn to substantive policy areas in our final section.

### Substantive Domains of Public Policy

To attempt to precisely define the themes and areas of interest belonging to any sort of discipline is always burdened with the risk of arbitrariness or a display of personal (and not necessarily refined) taste. This is a risk we also run. Nevertheless, we should consider it expedient to undertake a comparison of the themes and areas of social policy. We will concurrently demarcate social policy as an investigation of the process that creates and realizes policies influencing the relationship between individuals and the social conditions they live in. (Compare the following table)

**Table 1-3**

Fields of interests of public policy and social policy as scientific disciplines

While it can be said that certain policies are easily associated with either public

<b>Public Policy</b>	<b>Social Policy</b>
Human rights policy	
Environmental policy	
Security policy (internal and external)	
Migration policy	
Transport and telecommunications policy	
Media policy	
Economic policy (fiscal policy, monetary policy)	
Research and Development policy	
Innovation Policy	
Population policy	
Employment policy	
Housing policy	
	Policy of social security
	Education policy
	Health policy
	Family policy
	Policy of social inclusion and cohesion
	Policy relating to marginalised and endangered groups and individuals

policy on the one hand or with social policy on the other, others can be found in both spheres. According to Bulmer, Lewis and Piachaud (1989), social policy is not merely public policy, as it only brushes the edges of areas such as security, the armed

forces and agricultural policy. On the other hand, social policy also extends into areas which are not the domain of public policy, for example social support and assistance within small communities. Here, among other things, we encounter the discrepancy between the terminology traditions of the European continent, the home of social policy (Socialpolitik), and the North American tradition that gives preference to the concept of public policy. No doubt, that Central and Eastern European scholars, politicians and the public should and could profit from both traditions.

In the field of public policy, as well as social policy, there are also found themes not mentioned in the table such as the formation and implementation of policy as a political process, the redistribution of resources and justice in their distribution, problems stemming from the functioning and linking of state administration and self-governing, and problems of the relationship between the center and the regions (the formation and realization of local policies). Another current problem is presented by the concept and method by which privatization policy is put into practice. The issues of the European integration and global governance vis-à-vis the operations of the nation states are of increasing relevance as well.

Relations between economic, public and social policy deserve special attention. For example, fiscal policy is directly linked to the underlying context of the majority of the policies mentioned in the table. Public policy also regulates economic life where the public interest could be threatened (in the realm of anti-monopoly legislation) or nurtured (such as the stipulation of economic activities in the deprived areas). This economic dimension can thus be conceptualized as an integral component of public and social policy.

### **Conclusion**

Approaches to public policy are wide-ranging indeed. As we have seen in this chapter, there are a host of issues to consider in thinking about public policy in general, and in CEE in particular. It is a multidisciplinary field enjoying the contributions of political science, sociology, economics and others, yet by the 2000s, it has emerged finally as a area of scientific inquiry of its own. Considerations such as reactive versus proactive policy and liberal versus paternalistic policies are important. Particularly important are the relationships between the public and private sectors, although with recent reforms, those distinctions may be reduced. Between them is the growingly important non-profit sector, including NGO, Quangos, and other hybrids. Legal and organization approaches encompass more traditional approaches with the more modern policy sciences. Finally, one of the dilemmas of public policy remains the tension between the desire for scientific knowledge and demands for relevance at solving today's problems. Approaches to public policy can be described as falling along a continuum from basic research (comparative, and at the highest level of generalization) to the most applied (more narrow, focused, and country-specific). In fact, each point along the continuum has its own function and usefulness depending on perspective. The subsequent chapters in this volume will show a range of issues, approaches and methodologies.



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# Chapter 2



## **Economic Theories of Policymaking**

*Gyula Gulyás:*

This chapter considers the major theories that underlie the rapidly growing field of public policy. The economic and political theories, to be presented below, can be classified under two headings by their theoretical point of view. As far as the logic of their exposition is concerned, they can be deductive or inductive. In addition, they also differ from one another by whether they focus on the individual, the group, or institutions. Deductive theories set out from a relatively small number of basic postulates, or premises, and in harmony with the rules of deductive logic, they reach further conclusions, new experiences and knowledge by implementing these general presumptions to the particular phenomena. Conversely, inductive theories set out from the observation of individual, or particular phenomena and by comparing them they attempt to generalize empirical knowledge, or to outline some kind of a theoretical construct. The theories that set out from the individual and trace back each political phenomenon to the behavior or interests of individuals belong to the category of action theory. Group theories expound and explain societal and political phenomena in terms of intra- and inter-group activities. Finally, the theories that expect an understanding of political phenomena from research into organizations or institutions, mostly set out from reciprocity between the individual and the organization, with stress shifting to this or that direction.

### **The Theory of Public Choice**

The theory of public choice regards the individual the basic unit of analysis. This fashionable economic theory was named after the institution where the theory itself was elaborated in its first form (Institute for the Study of Public Choice at Virginia Polytechnic University). The theory applies the principles of neo-classical economics for the study of political behavior. Its most important presupposition is that the political actors, similarly to the market actors, are rational profit maximizers who take the principle of cost-effectiveness as the maxim of their behavior. This principle is applied to the study of voting, the relationship between political and economic systems, of collective decision-making and of governing institutions (including bureaucracy, legislation and political parties, as well as the Constitution). Accordingly, the electorate, being rational followers of self-interest, would cast their vote for those candidates and political parties who and which (presumably) would serve their interests. The theory interprets politicians as 'vote maximizers' (Downs, 1957) who compete for political votes because they can maximize income, authority, and prestige offered by public office only in the case of being reelected. Political parties, similarly to individual politicians, present such package plans that are attractive to the voter and consequently are potentially accompanied by gaining votes. Peter Shelf (1985) summarizes the essence of the theory of community elections: following the traces of this approach voting citizens may be identified with consumers, the interest groups may be regarded as organizations

of political consumers or as cooperatives, political parties may be interpreted as enterprises where competing packages of services and taxes are offered in exchange for votes, political propaganda can be compared to advertisement and commercial promotion, whereas government offices are to be treated as state companies, the activities of which depend on whether they get adequate political support to cover their expenses.

The theory of public choice represents the process of public policy as a series of interactions of political actors who follow egoistic motives. Voters expect an increasing number and diversity of programs and services from governments while strongly constraining their 'inclination to pay taxes', thus violating the norm and principle of reciprocity, as well as market exchange based on equal value. Politicians, political parties and bureaucrats are ready to meet these program expectations in case they can win votes by them, or if they lead to the increase of their budget. This series of interactions, where the actors of public policy mutually regard one another as mere means of their own profit maximization, will ultimately have two negative consequences: (a) one is that the state continuously and in an ever broader and deeper sense interferes into the functioning of the economy and society, often in the form of the 'political business cycle'. In other words, democratic governance functions in the form of 'a permanent' election campaign where governmental decisions that are 'favorable' or 'unfavorable' for the electorate vary in keeping with the time horizon of the election cycle: popular decisions are made right before the elections, and the unpopular ones are made soon after. (b) The other undesirable social consequence is that the makers of public policy, including the citizens, get into a type of situation like the dilemma of captives, namely that public policy does not result in the public good but in the public wrong.

The theory of public choice considers its own role in the interpretation of politics and public policy to be such a milestone like the appearance of classical economics had been in the history of economic thinking. As it is commonly known, classical political economy appeared as the critique of the doctrine of 'just price' elaborated by scholasticism: it challenged its normative and moral character and defined itself as such a positive science that wished to describe and understand the behavior of the economic system and of the economic actors, and not to set 'external' norms for their behavior as scholasticism had done. Similar to classical British economics, the theory of public choice also (a) critically relates to traditional political theories that are not based on economics, but are regarded as a branch of 'social ethics', (b) and sees its own role in laying the economic foundations of modern political science. This attempt to lay the foundations is associated with J. Buchanan and G. Tullock (1965), who, similar to other representatives of 'public choice', set out from two principles of neo-classical economics, namely: (1) from the principle of motivation, that the behavior and action of individuals has a single maxim: to rationally follow their self-interest and (2) transaction, exchange in an economic sense of the term, is realized between two economic actors only if the possibility of mutual advantages is involved in the exchange.

The institution of economic exchange, consist of a market that has two venues to which two, analytically separable interdependent decisions belong: (a) first, the individual has to determine whether he will enter the exchange relationship or not, (b) if yes, then he has to accept the specific conditions and roles of exchange. The institution of the market, the set of rules that determinis demand-supply-price, ideally means that: (1) no seller or buyer has a monopoly over these rules (the awarding and/or punishing mechanism of demand-supply-price as a spontaneous institutional order or a measure of value is not influenced by the actors' behavior); and (2) since the exchange is voluntary (no one is forced into it), the market realizes the mutual advantage for entrants because a rational (profit maximizing) individual by definition will enter only such an exchange relationship that is advantageous to him for some reason or another. Thus the theory of public choice, similarly to classical political economy (Adam Smith) implies that the market transactions of individuals following their self-interest will paradoxically promote the public good through an invisible hand, which is the precise opposite of the original maxim of their behavior (personal maximization of profit).

The same cannot be said about political 'exchange'. The actors of public policy do not differ from the economic actors in view of their motivations, because both the politician and the bureaucrat consider the rational following of their self-interest as the maxim of their behavior. However, exchange relations among the actors of public policy do not lead to mutual advantages (public good) because no institutional regulation of collective action has been found in the making of public policy that would constrain the 'exploitation' of one man or social group by another. Public policy is the mirror copy of the market in the theory of public choice, where the actors to contrast to market actors, refer to public interest as their motivation, but where political change results in inequalities, illegal advantages and the robbing of public good under the influence of a 'negative invisible hand'. (M. Friedman, 1996) The negative effects are the consequences of the (a) rational following of self-interest and (b) moral weaknesses (opportunism). The actors of public policy will continue to violate the institutional rules offering the frame of reference of their behavior until it benefits them; in the other words until the profit deriving from the violation of norm exceeds losses deriving from being caught. The question is how can constrain immoral public policy actor(s) who are violating norms, from obtaining unjust advantages from honest companions. How can one create an 'institutional arrangement' (set or rules) that would assure the promotion of public good and not violate the principle of the rational following of self-interest by the public actors? According to the theory of public choice, there is only one such institution, the market, and its set of rules channels the profit-maximizing efforts of individuals in a direction coinciding with the interests of community members. Hence it should serve as a model for the institutions of public policy.

If the argument is accepted that public good is the automatic end result of market mechanisms, then public policy is either unnecessary or, in a worse case, it is harmful. The theory of public choice does not go as far in its conclusions as, for instance, libertarians , who wish to limit the role of politics and public policy

to the 'minimal state', to the protection of personality and ownership rights, implicitly stating that the best public policy is the non-existent one. The theory of public choice also wishes to radically reduce the economic and societal interventions of government. Those interventions should be limited to 'supplementing' the market. For example the state should create ownership rights in areas where they are weak or non-existent in order to let the market forces freely act and (in contrast to decisions of public policy leading to squandering) allocate resources so that they it may have positive outcomes for the entire society.

One of the arguments against the theory is that it oversimplifies the principles of 'market logic' when it applies them mechanically to the world of politics, which that is far more complex than the market. In fact, the maxim of political action is not always the individual maximization of profit: their motives may just as much be symbolic, ritualistic, and altruistic as egoistic. The second, often raised argument is that, as a result of simplifications, the predictive force of the theory is weak. The statement for instance, that the competitive dynamics of democracy necessarily enhances the sphere of governmental functions, resulting in the swelling of the state apparatus cannot be corroborated empirically.

### **Neo-institutionalism**

One of the starting points of neo-institutionalism is the realization that theoretical approaches, based on the individual, or the groups as a collective entity, are one-sided and of limited validity. The name neo-institutionalism refers to the expression of self-definition by which this new way of viewing institution's differentiates itself from the earlier, general historical and legalistic approaches to the study of institutions. Actually neo-institutionalism is a theory essentially that is based on economics, often called new institutional economics. Neo-institutionalism has emerged from that question put in 'Kantian' style that "there are social institutions, how are they possible?" The question, of why there are such social institutions as like governments, companies, or churches , and what regularities their existence follows, was raised by economists prior to neo-institutionalism.

Up to the appearance of Williamson (1975) (who gave a new direction to the economic interpretation of organizations by the rehabilitation and development of Coase's 'forgotten' theory), there were two dominant trends in the economic approach to organizations. One of them explained organizations as a transaction between individuals and the 'organization', as such an exchange into which individuals (members of the organization) enter because their rational pursuance of self-interest can be better satisfied cooperation within the organization than by alternative forms of cooperation outside the organization. (This interpretation of the relationship between the organization and the individual strongly resembles the relationship between system and environment described by N. Luhmann, (1995. p.212), because the individuals are not part of the organization or system in either case, but they are independent entities, and since the relationship of these independent entities is an exchange relationship in which they mutually regard



each other as instruments, or, using Luhmann's phraseology, as environment.) The alternative interpretation of the organization sees cooperation in the organization in which the members constitute part of it and in which they follow collective aims. (1) C. Bernard (1968) and his disciples H. Simon and J. March argue for the existence of organizations in so far as they are able to offer advantages to their members that exceed the contribution they offer to the organization. An organization is created when the given potential cooperation (exchange between the organization and the individual) offers some advantage to the individuals if compared to other possibilities, or forms of cooperation. (2) Others, such as P. Blau and R. Scott (1962) say that a formal organization is such an "expedient aggregation" of individuals who exercise "concentrated force" to realize common and explicitly acknowledged aims.

The third economic approach to organizations goes back to Coase's (1960) theory of transaction costs. Coase considers organization as an alternative to market coordination and as an autonomous form of coordination (today called "hierarchy" by the literature) that solves difficulties and problems related to market exchange. Difficulties related to market transactions are related to contracts and to the fact that observing them results in costs for entrants in the exchange relationship. Costs emerge in relation to the very establishment of the contract (fee of the conclusion of contract) and also in relation to controlling the reliability and quality of the exchange partner and the goods or services involved: these are the so-called transaction costs.

Coase starts from the assumption that if separate producers do each activity within a complex production or service process, then the market exchange of their goods and services will be accompanied by huge wasting of resources, because transaction costs have to be paid after each and every transaction. All this adds up as loss, because the market price have two components: production costs and transaction costs. Firms and enterprises are set up precisely for letting the producers and service producers save on transaction costs and thereby make the enterprises more efficient. Firms and enterprises are created by the horizontal or vertical integration of separated producers and/or service providers. Horizontal integration means that economic complementary activities may be united into a single enterprise. For instance, such separated forms of activities of the complex process of wine production as production, sale, marketing, etc. can be integrated into a single large company. As a consequence, with the setting up of the company, the transaction costs are eliminated, and the economic relations (transactions) between the production units, the sellers and marketing people, are not mediated by the market but by the hierarchically structured company. Vertical integration emerges when the unification of the various kinds of activities is done under the leadership of a certain unit within the complex production and/or servicing unit.

Economics distinguishes between two kinds of organizations, asserting the logic of hierarchy provided they operate in a market or a political environment: namely private and governmental bureaucracy. The operation of the former regarded as

efficient, and the second as wasteful. This is explained by the presumption that the key of efficiency is rooted in market incentives, in the awarding and punishing mechanisms of the market, which is alien to the political medium.

According to representatives of the theory, the crucial role of institutions in economic, social and political life is to 'solve' difficulties related to information and exchange, to reduce transaction costs within economic, political, or social organizations. Thus, institutions are 'interesting' from the point of view of whether they increase or reduce transaction costs.

Another important area of the origin of neo-institutionalism is to be sought in the theory of ownership rights. In this case too, it was Coase who worded the known thesis. Namely, if there were no transaction costs, the allocation of ownership rights would not influence efficiency. However, as it was pointed out by Harold Demsetz, such costs do exist. Therefore, the allocation of ownership rights will influence effectiveness. It will reduce the cost of negotiations, as well as the information cost of contracting in a positive case. Demsetz and Armen Alchian (1972) tried to test the validity of the theory of ownership rights through its implementation for organizations. They analyzed the undivided whole group activity inside which it is impossible to isolate the individual contribution of cooperating agents.

The question is how individual achievement can be measured. The problem is the same as in the case of the moral dilemma of multi-actor action: how responsibility can be identified and distributed when, for instance, several actors contributed simultaneously to a wrong political decision. The problem is the dilemma of collective action. If those working together are considered rational profit maximizers, then we also have to face the problem of 'evasion' when each participant tries to minimize his efforts or to adapt the free rider's strategy. Now the question emerges of how the behavior of profit maximizing actors can be channeled towards cooperative action. The answer given by Demsetz and Alchian is that the theory of ownership rights is adaptable to the solution of such problems. In theory the cooperating partners could conclude a rational agreement to transfer decision-making to a third person since they are unable to decide for themselves which of them would withdraw from the effort, and extent to which each would contribute to the common achievement. Therefore, they employ a supervisor who, upon joint consent, would be invested with the right of sanctioning. It is not guaranteed, however, that the 'third party', the external observer, would be objective and impartial in his judgments. Therefore, we are forced to face the problem of the "bad infinite", the issue of who would control or supervise the supervisor. Demsetz and Alchian say that the dilemma can be solved if the cooperating partners agree on a fixed wage and if the right to dispose over the residue (profit) is transferred to the supervisor, so that he will not be interested in evading his task or in becoming a free rider. The allocation of ownership rights in this way 'solves' the dilemma of collective action because it ensures an incentive (the ownership itself) for all the actors by ensuring a bigger gain than under non-cooperation. The relevance of the

theory to public policy manifests itself in privatization and in contracts signed by the government with private companies.

Another variant of neo-institutionalism is the theory of agents. It has developed as a branch of the economy of insurance. Control and incentives are the most important problems in the case of insurance as well. The insurer is unable to check the behavior of the insured because of the lack of adequate information (and it would be too expensive as well), as the latter may use the dubious means of 'moral hazard', provided the maxim of their behavior is not morals of the Kantian type (or of some religion), but, let us say, utilitarianism. If for instance, someone purchases an insurance policy valued of HUF ten million for a house worth only half that sum, he would be inclined to neglect fire safety, because if the house is burnt down the sum received from the insurance company would result in a profit. The question is how contracts can be written that exclude or not make moral hazard abuses profitable. In practice, insurance companies try to solve the problem by sharing part of the risk with the insured, incorporating this provision into contracts in the form of 'deductions'.

The issue is worded in more general terms in the theory of agents. A contract concluded by the commissioner and the agent, and its implementation would just as much raise the possibility of moral hazard (opportunistic behavior) as one between the insurance company and the insured. The problem to be solved (effective contract) is also similar. Namely, that in both cases it is the dilemma of collective action; how one can 'force' the commissioned to proceed according to the interests and intentions of the commissioner, rather than following his own interests. Opportunistic behavior, when the commissioned does not act in the interest of the commissioner, has several preconditions. (Williamson, 1985) (a) One is that the commissioned possesses information or knowledge the commissioner does not have. This is called information asymmetry, or the commissioner's cognitive incompetence. The citizen, as the politician's commissioner, is unable to comprehend the operation of the political machinery, just as the commissioner of a governmental office, the elected politician, does not possess the expertise of the bureaucracy by which political will is put into practice. The commissioned does not only possess a monopoly of information and knowledge, but also might profit from keeping it a secret. (b) Another precondition of opportunistic behavior is to be found in the character of the commissioned: the commissioned becomes an opportunist when he puts his own interest above the commissioner's interest if he is dishonest. If the commissioned is unfair, he is going to cheat, steal and lie in his relations with his partner, provided such an opportunistic behavior is more lucrative than the alternative possibility of being honest. The commissioner can only be convinced about the reliability of his commissioned agent acting in the interest of the commission, if commissioner controls him or gets him controlled. In other words, if he pays the related transaction costs.

It is at least equally important to study the theory of D. C. North, focusing on the changes and achievements of institutions from the point of view of public

policy. North (1993) considers institutions a determining the 'rules of the game' that structure interactions among people by compulsions and incentives, thereby reducing their uncertainties. The compulsions and incentives set by institutions may be formal ones like regulations, or informal ones like conventions and codes of behavior. Besides reducing uncertainties, the role of compulsions and incentives spelled out in regulations and conventions is to make the violation of rules costly by penalties and to make rule-observing behavior profitable by premiums. In this sense, institutions are means and sets of media that promote the efficiency of interactions. North differentiates between the concepts of institution and organization which are used in daily parlance as synonyms without any differentiation. He illustrates the relationship between institution and organization with the example of competitive team sports. In a competitive team sport, the institution is identical with the set of rules determining how that game should be played that is permitted and what is prohibited in the field. The team, itself is the organization in the Northian sense of the term.

The role of the organization is also to structure interactions among the individuals within the framework of the conditions described by the rules. Remaining with the example of team sports, the aim of two competing teams is to win the match. This can be accomplished by the team (the organization) that, parallel to observing the rules (the institutional framework of conditions), structures interactions among the team members: it combines the abilities of team members; it elaborates strategies in the interest of victory; and it coordinates cooperation of the team members. According to North's institutional theory, one should think about social, economic and political organizations in terms of the analogy of team sport. These organizations also have aims that are achieved by the elaboration of strategies, by the combination of internal resources and the coordination of cooperation, similar to sport teams. The relationship between institutions and organizations (rules and strategy) is one of interdependency in which the institution enjoys priority. According to North the institutions generate the organizations and it is by the rules that the institutional framework draws the playfield and the sphere of possibilities in which the organizations may elaborate their strategies, combine their resources, and coordinate cooperation inside them, while they observe the rules. But 'interaction' between the institution and the organization is not mechanistically deterministic. In other words, the organizations possess relative autonomy manifest in that they are capable of reacting to institutional rules. According to North one may find the explanatory principle in this dialectical reciprocity of why and how institutions and organizations change. Institutional changes are usually incremental and almost never discontinuous or revolutionary. This is related to the fact that the two types of institutional rules, formal and informal ones, are embedded differently in society and culture. Formal rules can be changed by legal or political decisions, but informal rules, customs linked to culture, traditions, conventions, etc., resist this sort of 'artificial' modification. The 'inertia' of cultural tradition is not only the explanatory principle of why institutional and organizational changes based on it are evolutionary rather than radically revolutionary; but it also sheds light

on why the historical past and historical future constitute an organic continuity through the institutions.

Institutions may claim special significance and interest in the world of politics and public policy because it is the formal and informal rules of political institutions that (a) determine the 'societal roles' of politician and bureaucrat; (b) offer a basis of legitimacy to public policy actors; (c) offer consistent rules of behavior, norms of evaluation, concepts formed about reality, emotional ties, etc., to those who make public policy so that they may perform their role consciously; and (d) create the framework of normative conditions within which the political organizations elaborate political strategies and various forms of political cooperation. Even prior to neo-institutionalism, scholars engaged in the study of organizations stressed the significance of institutional roles, institutional routine, symbols and institutional obligations but did not grasp the issue in its full complexity.

There are differences among the representatives of the neo-institutional approach, yet they agree in two significant things.

1. They agree in that it is the institutions that shape politics and public policy. The rules and procedures of the institution structure the behavior of the politician and bureaucrat; they determine the identity of bureaucrats; and, consequently, they greatly influence the ultimate outcome of public political processes and decisions.
2. There is also consensus that the organizations are shaped by history and cultural tradition. No matter how strongly external or internal factors may affect the life of organizations, these influences will break up on the 'inertia' of institutions. The sphere of options available for of public policy makers is determined in each case by the dynamic interrelationship of institutions and organizations. Similarly the interpretation of political problems, the aims that may be chosen and the set of possible solutions and means are also defined by it.

(The empirical 'testing' of dynamic reciprocity between the institution and the organization is associated with the name of R. Putnam. (1993) Putnam wanted to find an answer to the question of how the tremendous difference in output that may be found in the operation of the political system of the southern and northern regions of Italy can be explained. Up to the early '70s, such problems of public policy as public health, or public security were 'solved' by the central government in Italy. Local officials and offices were under the control of the prefect who reported directly to the central government in Rome. In the mid-'70s, it was decided to decentralize and democratize governmental activities. This was accompanied by the setting up of regional governments. Subsequently, the solution of the regional problems of public policy became their job. Putnam found that though the new democratic institutional and organizational system was introduced simultaneously in identical form in the entire country, it proved to be a success in the North but not in the South. What was the reason? He interpreted the data of an empirical survey covering the entire country and lasting for much longer than a decade along two dimensions. First, he regarded the new democratic system

of institutions and organizations as an independent variable. His results showed how institutional changes had influenced the identity, authority and the strategies of public political actors. In the first part of his research, the new, formal set of institutional rules seemed to be the cause of the positive changes that could be experienced in the organizational system of public policy in the northern regions. Here, the actors of public policy identified themselves with the democratic rules of the game. Their exercise of authority was based on the principles of democracy and on the participation of the civic community. Their political strategies tried to meet the criteria of efficiency as well as social justice. Whereas data showed that in the underdeveloped South, politicians and bureaucrats did not identify with their democratic political roles, because they were recruited from the traditional local elites. Instead of the principles of democratically resulting in the participation of the civic community, the style and content of public policy were determined by the vertical power and dependency relations of patron and client, and public policy programs were oriented towards the clientele and were elitist.

On the basis of the new formal rules of institutions, one cannot explain why the strategies of political organizations, forms of cooperation and coordination between political actors show such sharp differences between the northern and southern regions. The difference is explained however, by viewing the formal rules of the institution, and the system of organizations based on it, as dependent variables. On this basis, Putnam obtained the result that the informal rules of the institution based on reciprocity, the cultural tradition owned up by every member of the community, the norms and values of the 'civic community' such as solidarity, confidence, community spirit, reciprocity in political interactions, etc., are the factors that determine: (a) to what extent they will internalize the formal (deliberately created) rules of the institution; (b) what strategies will be followed within the organizations; and (c) what forms of cooperation and coordination will be applied. Putnam noted that in the North, which had a strong civic community, the behavior of the actors of public policy was based on such political virtues as honesty, confidence, respect for the law, readiness to cooperate, solidarity, participation, self-control, etc. He noted that exactly the opposite conditions were found in the South where civic culture was entirely missing. Here evasion of the law, free-rider strategy, corruption, envy, selfishness, inability to form groups in civil society, total indifference towards the issues of the public, violence and general mistrust of people towards each other and public policy were the general features.)

Neo-institutionalism regarded institutional structures as the building blocs of economic, social and political life. Perhaps its most important message to public policy is that it is the historically conditioned moral and political set of values, with its moorings in cultural tradition, rather than anything else, that fundamentally determines the political life of a country, including the operation of political organizations and the behavior of public policy actors.

## The Political Economy of Welfare

Welfare economics is the most frequently used approach to public policy. What is called public policy analysis in common parlance is practically nothing else but applied welfare economics. This approach, as well as economics in general sets out from evidence that a market economy is consistent with the rational model of societal decision-making. Welfare economists, however, recognize the fact that the market is incapable of efficiently allocating resources in each case, or, to put it differently: even the market is unable to aggregate individual profit maximizing efforts so that it is optimal in terms of the total welfare of society. As contrasted, for instance, to libertarianism, according to welfare economists, the market does not automatically maximize the public good. Welfare economics implies instead that political institutions can be operated in a way that allows for corrections of so-called market failures. In this sense they interpret public policy as either (a) a supplement to the market, or (b) its substitute.

The principles of welfare economics were laid down and systematized first by the British economist Pigou, who was perhaps the first to recognize the relationship between market failures and public policy, even though he mentioned only a few forms of market failures. One form of market failure (a) is monopoly, which is a consequence of imperfect economic competition involving the possibility that a monopoly may raise its price above its marginal cost. This will cause a loss to consumers, a social cost. The next form (b) of market failures is imperfect information that results when producers or consumers are not sufficiently informed to make well-founded decisions. Pharmaceutical companies, for instance, do not always inform the users of a given medicine about its adverse side effects, and patients do not possess the specialized knowledge necessary to check the product in question. Under the aegis of imperfect information, decisions may be taken that serve group, or institutional interests, but result in societal losses because costs occur that have to be paid by consumers and taxpayers. (c) Negative externalities constitute the third commonly known form of market failure. The most often quoted example is environmental pollution. If, for instance, a factory emits pollution harmful to nature, as well as to the human environment and does not cover the cost of deterioration in the health condition of the population living nearby, then it causes societal damage. (d) The tragedy of public grazing lands is a further example of market failures. Such a market fault occurs when commonly owned resources are used without strict regulation by actors who are following their self-interest and the outcome is that, even though the users of the resource profit from the more intensive utilization of the resource in the short-run, society as a whole suffers losses in the long-run. For instance in the classical example, farmers keep on driving an increasing number of cows to a pasture, but in the long-run they will have to pocket losses individually as well as collectively, because the grazing ground will turn into a desert. (e) Destructive, or aggressive competition among companies is a market failure that has negative consequences for workers, as well as for society. As a result of such an excessive competition, profit may fall, fol-



lowed by an otherwise unnecessary reduction of wages, by deteriorating working conditions, and so forth, thereby adversely affecting the welfare of society.

As welfare economics considers it evidence that market failures should and could be corrected by political means, the decisive political issue concerns be the most efficient solution of market failures. From an economic point of view, the most efficient solution will obviously be the least costly one. The technique of cost-benefit analysis is used for its determination. The practical utilization of the cost-benefit analysis it intended to produce a given result with the smallest investment, or, to put it differently, to achieve the largest benefit with the same investment. The analysis: attempts to achieve two goals: (1) an assessment of alternatives and their expected consequences, and (2) the alternative that maximizes profit and minimizes investments. Essentially, cost-benefit analysis is a technique serving the purposes of making governmental decisions approximate market decisions as far as possible. More exactly, the techniques of economics are used for the realization of Pareto's optimal public policy alternative.

Pareto sets out from the premise that welfare is defined by efficiency, and market allocation is its most adequate instrument. According to his presumption, interactions continue among the market actors until all participants are satisfied and one of the parties could get into a better position only if he made another's position worst. This condition of efficiency is called Pareto optimality. It is on the basis of such a norm the different market allocations can be evaluated. But it must not be assumed that it is an interpersonal norm, such as moral norms, that is valid for all actors. Instead, it is merely an expression of a subjective sense of satisfaction or judgment. This is the manifestation of the actors' ordinal preferences. Independently of one another, they rank different social conditions. According to Pareto, the end result of an allocation is higher than the initial condition, if nobody's situation has deteriorated, but at least one person would assess the new situation as better than the initial one. An allocation is Pareto optimal (rational and efficient) if further transactions cannot be performed without the deterioration of somebody's condition in the potential new situation. One difficulty with Pareto optimality is that several such conditions can be envisaged simultaneously (depending on the situation of the actors in the original condition) and that the optimal conditions in Pareto's sense cannot be compared to one another.

Several followers of welfare economics regard the separation of efficiency and fairness as one of the greatest merits of Pareto's theory. This separation, however, raises serious moral and political issues. (Zajac, 1995. pp. 76 – 77)

- (1) First, a strict Pareto development occurs in the most singular occasions.
- (2) Second, even if it is assumed that Pareto development does exist (the situation in which everybody improves in the new condition), the question of how the total gain deriving from development should be distributed still remains unanswered. In fact, it is difficult morally to defend one party acquiring, let us say, 99 % of the total gain, whereas the other receives only the remnant.



Pareto's theory cannot be mechanically applied in public policy, as assumed by several economists, because governmental decisions always have winners and losers, and this contradicts the Pareto optimality principle. For instance, the social insurance of the poor, financed by income tax, would put the rich into a worse situation. Therefore, it is not Pareto optimal. If a criminal is locked up in jail, it is also not optimal, because his situation has worsened. The theory of N. Kaldor (1939) of Hungarian origin intended to resolve the difficulties related to the Pareto principle. The so-called Kaldor criterion, as contrasted to the Pareto criterion, merely demands that the net benefits from a chosen public political alternatives should surpass its cost. Based on this criterion, a decision can be made for a certain public policy if it has losers, provided the sum of the entire gain is bigger than that of the losses. Within the implementation of the Kaldor criterion, a mechanisms for distribution could be applied that would make it possible for the winners to compensate the losers. In principle, this would satisfy the Pareto criterion.

Recently, a theory of governmental failures was also elaborated besides the theory of market failures. Its most important postulate is that governmental activities aimed at the elimination of market failures broadly influence the operation of the economy; but they may have such unwanted consequences that they do not help but instead, hinder the market's ability to produce goods and services. To put it differently: it is possible that public policies will negatively affect the level of net social welfare. This is a warning that governments do not only have to be careful when attempting to correct market failures; but, before they attempt to correct them, they have to investigate whether they possess those abilities, resources and skills, etc. that would make it possible. Theoretical considerations and criticisms related to governmental failures have led welfare economists to re-conceptualize the traditional concept of market failures. For the purpose of a more precise definition of the role of government and markets, they have elaborated a typology of goods and services. This typology classifies the goods and services that can be found in society into four types, in keeping with the criteria of exclusivity and exhaustiveness that is, on the basis whether the goods or services are limited to a single act of consumption and whether they can be completely consumed during the course of transaction. Exclusivity and exhaustiveness can be regarded as two variables that determine of a simple matrix, within this matrix four types of goods and services can be distinguished. The following figure schematically presents this simple grouping of goods and services. The figure is taken from the work of S. Savas. (1977)

### General Taxonomy of Goods and Services

As it can be seen from the figure, private goods constitutes one extreme type of good produced by society. These include such goods and services as food, haircut, etc. These goods and services will not be accessible by others after their consumption, because they are used up in consumption. Their common feature is that they are distributable. Public goods and services are found at the other

<b>Exclusivity</b>	<b>Exhaustiveness</b>	
	<i>High</i>	<i>Low</i>
<i>High</i>	Private Good	Toll Good
<i>Low</i>	Common Pool	Public Good

extreme. This include the defense of the country, street lighting, legal security, etc. Once these goods are produced, the consumption of them does not reduce their quantity. Moreover, there is no way to use a market mechanism to change individuals for using them. Toll Good and Common Good are found between these extremes. The former category includes such quasi-public goods and services (goods that are more or less public) like bridges and expressways that are quantitatively not reduced by use, but it is possible to charge for their use. Those goods that belong to the sphere of Common Pool include the fish of the oceans. An individual does not necessarily have to pay to consume this goods, but their quantity is reduced by use.

According to the principles and intentions of welfare economics, governments should not interfere with activities and transactions that are related to private goods. Their allocation should be left for the market. The task of the government should be to safeguard the purity of market transactions by protecting ownership rights, preventioning crime (theft, forced contracts, etc.), and so on. Conversely, the provision of public goods must be a governmental task, because the market does not provide such goods and services as they do not produce adequate profit. Governments must prohibit the treatment of toll goods as public goods, by charging a fee for their use. Logical consistency and fairness would dictate that it is irrational and unjust to burden all the taxpayer citizens for the building and maintenance of bridges and roads by offering exemption from fees to those using these goods. If this is what happens, it will encourage the users tread these goods and services as public goods. Our sense of justice and reason would dictate that the cost of building and maintenance should be paid by those who utilize and avail themselves of these goods and services. In the case of Common Pool goods, welfare economics implies that the state and government create a system of ownership linked to licensing in order to prevent the exhausting and exploitation of these goods to the extent suggested by the tragedy of public grazing lands. For instance, quotas should be sold in public auctioning that would allow those who have been successful at the auction to fish for a certain quantity of fish.

Objections against and criticisms of welfare economics do not touch upon the above typology of goods and services but rather on its theoretical foundations. One of the most serious objections is that this theory reduces the making of public policy to a technical and methodological problem. It does not recognize that the bases of governmental activities are not hidden in scientific techniques but, for instance, in the paradoxes of value choice. Even if we accept that social science is

capable of laying the foundations of governmental (public political) decisions in other words, it is capable of determining which would be the most efficient and effective public policy the actual decision would be a political (and not scientific) one because the transfer of a decision 'founded' on and recommended by science into practice would be limited and modified by politicians who want to achieve political aims and not scientific ones, and who (consequently) base their decisions on moral (in an ideal case) and political value judgments, rather than on neutral scientific truths.

### **Pluralism**

Pluralism, a prominent inductive approach to public policy making focuses on the group. The pluralist approach to public policy developed in the U. S. and has been one of the dominant trends of the interpretation of public policy since its birth. Though the pluralist approach to public policy may justly be considered a typically American invention, in addition to the U.S. (James Madison), the roots of the theory go back also to the Continent (Alexis de Tocqueville). More over, the doctrine received its first broad and profound foundations in the work of Arthur Bentley. Though with the passage of time the theory has been modified at several points, the statements postulated by Bentley were not refuted by even such later representatives such as David Truman, Robert Dahl, or Nelson Polsby. The pluralist theory is based on the presumption that it is the interest groups that play the most important role in the processes of public policy and in shaping politics. In his famous book (*The Process of Government*), Bentley (1908) postulated that society was nothing else but the complex of groups constituting it. According to him, interests and groups can be mutually identified in society; every identifiable interest will 'find' the group (consisting of individuals following similar interests) in which it can be manifest in concrete and adequate form. Truman (1964) toned down Bentley's statement by distinguishing latent and manifest interests. In his system of thinking, it is the concept of latent interest that constitutes the potential base of group organization. While the interest remains latent, the group is only a possibility. According to the pluralist theory the groups being organized along various lines of interests are themselves of many kinds due to the multiplicity of interests. The groups are freely formed (without the application of force). Therefore, they lack the monopoly of representation and do not demand absolute loyalty from their members, which would exclude the possibility for people being simultaneously members of several groups. The person who follows his own specific interests may naturally be a member of several groups. Group memberships crossing one another are assessed as something that can have decisive importance in appeasing inter-group conflicts and in promoting cooperation among groups. It is further colored by the fact that the same interest may be simultaneously represented by several groups that peacefully compete in acquiring and retaining members, with the eventually beneficial consequence that all interest groups will represent. These interests that are articulated by them as their basic goal.

Pluralist theory postulates public policy as a process, the most important function of which is to make peace and to reconcile competing interests. Ultimately, public policies are the results of the competition and cooperation among groups manifesting 'collective' interests.

The pluralist approach to public policy regards governmental offices as the arenas of public policy making where groups professing different sets of values are involved without exception, in the collective process of public political decision-making. To put it differently, it treats governmental bureaucracy as the 'representative institution'. In other words, it identifies public policy with administration. "From that point of view a good administrative decision was one that summated the preferences of the groups that appeared before the agency in the same way a good election was one that summated voter preferences." (M. Shapiro, 1988. p. 134)

Criticisms related to pluralism often attribute such postulates to pluralist theory (and then they are refuted) that it has never explicitly professed as its own. The advocates of the theory, for instance, have never suggested that every group has an equal opportunity to influence government, or that every group is equally successful in persuading the government. However, it is difficult to disperse the suspicion that this statement is implicitly present in the theory. MacLennan's words can only confirm that suspicion. It is impossible to read advocates of pluralism without the feeling that the resources, information, and the means of political communication are equally open and are accessible to every citizen and that different groups constitute centers of equal specific gravity in society; and consequently, that every legitimate voice has the possibility of manifesting itself. The most cogent critical argument against pluralist theory is that it is unable to create a coherent group theory that is able to explain why there are differences among groups in those resources, that are indispensable for influencing government. It is not quite unambiguous either as to what the place and role of the state and government is from the perspective of pluralism.

The early representatives of pluralism argued that the government had to play the role of a transmission belt (and it did play that role in their view) by registering and satisfying all those demands that were made by interest groups. They did not regard government as a real entity, but rather as a 'place' where various competing interest groups could meet and talk. Under the influence of criticisms that have challenged the reality of this assertion, pluralism has reconsidered the role of government. According to the new concept, this role is similar to the role of a 'referee', 'arbitral tribunal', or 'broker between competing wills' in interest groups. Carl Schmitt, presumably correctly, blames pluralist outlook for being nothing else but the theory of disrupting and negating the state by doubting the principle of the unity and sovereignty of the state. It reduces the status of the state, defined as a 'political association', to the level of the status of economic, religious and other kinds of associations. In this way, it challenges the specific content of politics, and even its right to existence.

Another objection can be raised in relation to competition and balance among interest groups. The not unfounded question can be asked about what happens when alliances of interests or monopolies emerge between the branches of power, which are separated from one another and the interest groups? What would happen if, for instance, bureaucracy entered into alliance with one interest group and against another one; or if the majority of a parliamentary committee did the same? Or, what happens if the various areas of public policy contained and allocated largely different quantities of goods? For example, imagine that pluralist players compete for and bargain about 500 units of distributable goods in the public policy sector A, while those competing in public policy arena B do the same but only for about 50 units of distributable goods. Taking this disparity for granted and assuming that the number of competitors is equal in both areas of public policy, the result would be that a larger amount of goods is allocated in public policy arena A than in B. In other words, the negotiating process and competition contain inequalities.

Neo-pluralism represents a more moderate stand on several issues than the classical version did, but it does not revise the basic principles in any way. Neo-pluralists, for instance, do not assert that competing groups would be equal in respect to their resources and opportunities, but to the contrary. Charles Lindbloom for instance, says that business groups have greater power and influence than other groups for two reasons:

1. Business performs existential functions in the life of society (building homes, food production, transport, etc.), which, if not fulfilled, would result in riots. If the private economy were unable to perform such tasks it could even lead to the fall of government. It is a prosperous economy that constitutes the basis of governmental activity because taxes constitute the most important source of resource for governmental programs. It is business that produces possible those funds that politicians spend on their own reelection.
2. Economic growth is only possible with the confidence of business life. Thus, governments have to pay attention to the expectations (or demands) of business, because business leaders will only perform their key role if the profits and advantages allocated to them are convincing.

The strongest attacks against theories of interest groups are associated with Theodor Lowi (1969) and Mancur Olson (1987, p. 122). In his criticism of pluralism, Lowi said that the American government did not perform the mediating role of referee or stock exchange broker any longer, because it has become the prisoner of pressure groups. In his criticism of interest group pluralism and Liberalism, Lowi also stated that governmental politics and policy making are fragmented in general, which means in his view that governance as a whole has been fragmented into various 'sub-governments', appropriated and controlled by individual interest groups. Olson considers interest organizations 'coalitions of distribution' that represent narrow and selfish group interests to the detriment of those social strata that are unable, or less able to articulate and represent their interests. Achieving group interests by bargaining with the government (for instance prices and wages

setting by the authorities) would enhance the income of the interest group members, while reducing the effectiveness of societal production, because they obtain a bigger part of the social cake without proportionately contributing to its creation. Hence, the selfishness of interest groups results in additional cost to society and increases political tension within the community. Interest organizations may also increase social cost by making legal regulation more complicated.

If there is no balance of power among interest groups, then pluralist power arrangement, paraphrasing Olson, would lead to the decline of nations, because:

1. It reduces economic efficiency since the producers expect the state to solve their economic problems (they want to obtain profits by bargaining, rather than obtaining them in competition),
2. It leads to social injustice because the favored groups do not share the national cake in proportion to their performance,
3. Items 1. and 2. jointly undermine labor morals and moral values in general.

### **Corporatism**

While pluralism can be regarded as the dominant political group theory in the U.S, in Europe the same role is performed by different variants of corporatism. The roots of corporatism go back to the Middle Ages, when special attention was paid to the protection of autonomous associations, to the so-called 'intermediate strata' occupying the space between the state and the family. They included such associations of civil society as the guilds, religious organizations and churches, and the different professional and occupational associations. Corporatism regards these intermediate strata as entities that have (a) an autonomous existence above the individuals, and as such (b) enjoy priority to individuals. In this respect, corporatism may be justly regarded the antithesis of pluralism. As contrasted to pluralism, corporatism is an interest-mediating system in which the constituent units – the state, the various organizations and institutions of civil society, and the families – are organized into a functionally differentiated, strictly hierarchical order. Here the interest groups (corporations) are not freely and voluntarily formed, as it is in the case of pluralism, and their relationships are not expressly regulated by the competitive market. The groups of intermediate strata do not possess undivided autonomy either, because their existence is a function of the acknowledgement and support by the state. The practice of corporatist public policy, and the conservative set of thinking expressing it, seek a solution to two public policy problems that have been neglected by pluralism, namely: (1) the role of the state in the whole of societal reproduction, (2) and the forms of the relationship between the state and the interest groups.

According to conservative theory, public policy is shaped by interaction between the state and the interest groups acknowledged by the state. Inter-group action is institutionalized and mediated within the state. As contrasted to pluralism and liberalism, setting out from the individual or from a group expressing the individual's interests, the axiom of corporatism is that the sets of institutions of the state,

civil society and the family, and their relationships, constitute the primary societal fabric that is a precondition to individual freedom, as well as a precondition to contractual transactions among individuals. According to conservatism, the values of freedom and autonomy, and the rights and institutions deriving from them (contract, market), cannot be regarded as primary societal aims because this would challenge man's role as a community being. Conservatism has a critical attitude to all governmental policies that regard freedom (rights of freedom) and individual autonomy as objectives to be achieved and/or as the basis of its own legitimacy. The source of the individual's identity is not to be found in individual autonomy and freedom, but in the duty and responsibility of individuals towards institutions. Consequently, the aim of conservative public policy is directed towards cultivating and strengthening institutions and corporations. (Scruton. 1995. p. 20)

Hegel, (1971) who was a conservative theorist, described society as a dialectical and dynamic system (corresponding to the three basic societal institutions the state, the institutions of civil society and the family), which is organized into a uniform unit and legitimated by three kinds of obligations that individuals have: towards the family, towards contracts, and towards the state. Individuals have obligations towards these institutions because the latter ones assure their survival and welfare. (H. Marcuse, 1982) As contrasted to liberalism, which views obligations as emerging only by contracts into which individuals enter voluntarily, conservatism holds that the individuals do not have to shoulder the obligation of citizen loyalty, or to meet their family obligations because they have entered into a contract with the state and with their family members, but because these institutions are the frameworks of their social existence and the sources of their personal well-being and self-realization. Individuals owe obligations towards corporations, interest groups, and all the institutions of civil society for same reason.

E. Durkheim (1992), who held views similar to those of Hegel, started from the premise that the thinking of the age is determined by two contradictory and one-sided social theories: Liberalism and communitarianism, both drawing a sharp caesura between the private and the public spheres, and the values associated with each. There are the individual rights and personal dignity on the one side, and tradition and public good on the other. Similarly to Hegel, Durkheim saw his task in reconciling the two opposites. Setting out from Aristotle, he found that (a) the moral behavior of individuals depended on the ground where life is manifested, on the social subsystem in which the individual actually moves and that (b) these forms of behavior are different under the various constitutions. He himself described four spheres of social life (family, civil sphere, economy, and political community) to which different forms of moral argument and vocabularies can be linked. He called such a branching off of morals by spheres as moral particularism, moral pluralism, and also as moral polymorphism.

Such a separation of morals takes place along the functional differentiation of the society. The fragmentation of society into 'social milieus', and the consolidation and autonomy of these milieus create adequate moral beliefs and practices. Among



the different 'moral domains', however conflict is frequent, just as it is within the sets of moral views. The question is on what basis priorities can be established, if at all, among the competing morals. Durkheim argues that there is one among the life spheres that enjoys special distinction and that is the political community. The moral of this sphere is citizen's moral and, as such, it is also distinguished in comparison to the morals of the other areas where life manifests itself. If, for instance, the sphere of the family or of the economy were completely independent of the citizen's sphere and consequently of its morals, or if the two former ones dominated the latter one, the result would be (a) pluralism of the laissez-faire type, which, in an extreme case, would lead to the dominance of a single sphere and its morals over the entire society, or (b) conversely, if the political sphere dominated over the rest, it would result in statism.

The Durkheimian concept of the distinguished political community covers the totality of the broad plurality of 'secondary groupings' (professional associations, interest representations, occupational communities, the family) without itself becoming identical with them. On the contrary, a significant feature of the political community is that there is discord between the governors and the governed, between representatives of authority and those who do not belong to this group. The political community is the union or the unification of secondary groups subordinated to the same authority. The political community is not identical with the state either, because, according to Durkheim, the state is the supreme organ of the political community and, as such, it is a mere instrument in the hands of the community.

In Durkheim's theory, the state, the individual and the corporations (secondary groups) form a dialectical and dynamic unity that is similar to Hegel's solution; inside it the various parts mediate each other's existence and function as each other's mutual control as well. The state protects individual rights by its law courts in the face of secondary groups (family, profession, occupational group, economic branch) that are inclined to absorb the individual and to neglect his freedom. It is the moral responsibility of the state to 'remind' the secondary groups that they are merely parts of the whole and that their particular interests are not identical with the public interest. This function of the state includes such things as the protection of the child against paternal tyranny, and the protection of the worker against corporate autocracy. But what constrains the state in exercising autocracy over the individuals? Durkheim's answer is that it is the secondary communities that represent counterbalance to the state and exercise control over it. Disregarding accidental conflicts, there is no real conflict between the state and the secondary groups.

According to Durkheim one of the reasons is that without the existence of secondary groups the mediating relationship between the state and the individuals would be lopsided because either the state would be too distant from the individuals to play its role effectively, or, conversely, it would control too many aspects of personal life. In Durkheim's view, there is a dialectical relationship between the



state, the efforts of secondary groups, and public good. In the service of public good, the state constrains the dominance of secondary groups over individuals, which is an important component of the concept of the public good. In keeping with the principle of reciprocity, the secondary groups keep the state from growing into a Leviathan. Hence, they also contribute to the public good. In addition, the existence of the secondary groups plays an important role not only in restricting the emergence of an absolute state, but also in keeping the state from becoming excessively weak.

In an ideal corporate, associated order, the key actors would be the organizations exercising pressure (corporations), the activities of which are determined by three common goals: (a) the associations protect, represent, and promote their functionally defined interests (that is, the interests of the social group, economic sector, professional or occupational group), (b) it is part of the tasks of corporations to 'defend' the members of the group in question as individuals and to safeguard their opportunity for professional self-realization, and (c) to promote the general interest or public good as well.

Corporations limit the individualism of civil society, as well as that of market rationality and remove the individual from the isolation and cold cruelty of civil life. The corporation itself is a kind of socio-economic association of individuals that is based, for instance, on a common profession or activity that unites the atomized individuals of civil society into a 'single moral whole' and assures for them a certain level of economic security. According to the interpretation of Hegel by M. Prosch (1997, p. 203), the ethical and the economic functions of corporation are directly related: the moral aspect functions of corporations is part of their economic and social function. (Corporations play the role of 'educational institutions' for their members: they are educated in keeping with the general interests of their profession or activity.)

This 'self-regulating' right and role of corporations assures the independence of economic enterprises and the subjective freedom of individuals in choosing their occupation and form of existence. Corporations play the role of a kind of 'quasi-family' in the life of their members, who relate to one another as 'companions' and not as competitors. In the corporation, it is solidarity and not selfish profit maximization that is the individuals' maxim for action. Hegel says that corporations create 'objective morals', professional morals within civil society, that is achieved by a demand for professional honesty. In his view, the weight of the moral role of corporations is also demonstrated because 'professional honesty' is the only concrete and valid form of virtue in civil society. In Germany, even today, a large proportion of private producers in agriculture, industry and commerce, as well as persons of professions such as self-employed doctors and lawyers belong to the corresponding chambers that define and enforce professional norms and the rules of proper life. It is important to stress that the leading functionaries of chambers do not only represent the members of organizations exercising political pressure but also the authority of the government over their membership. Therefore, these

organizations play a kind of role of the 'mediating middle' in the assertion of interests because they represent civil society and mediate its interests towards the state, while they also mediate the state and/or public interest towards interest groups and civil society.

The relationship among corporations is characterized by the mutual acceptance of the principle of reciprocity by way of accepting 'strategic interdependency' (L. Edinger, 1993. p. 186). If, for instance employees achieve ages that are too high, it would reduce the employers' profit and, consequently, their inclination to invest. Conversely, if employers succeed in the introduction of taxation, the burden of which is to be carried by wage earners, it will produce dissatisfaction on the side of employees. This system of mutual dependencies encourages the parties to seek 'just' pacts, which can be achieved only if the 'contracting' interest groups are (1) symmetrical in resources and in the ability of interest representation, in other words if they have equal power or influence; and (2) monopolize the representation of the members of the economic branch, profession or occupational group in question. (In Germany for instance, influencing governmental decisions can take place only through large summit alliances that often force the organizations constituting the alliance to subordinate their particular interests to the interests of bigger federations.) A high degree of inequalities of resources, or a fragmentation of interest representation excludes the possibility of stable accords between the interdependent parties; the former because the stronger party is not forced to negotiate and the latter because if several organizations are struggling for monopoly position in an area, it fragments energies and greatly weakens negotiating positions.

Corporations cannot afford to set aims for their members, or to be engaged in activities that run counter to the 'general interest' or 'public good' in general. What guarantees that this does not happen is the state itself. This does not mean, however, that the aims to be realized would be mediated by the state to corporations, or that it would elaborate their rules of operation. Every branch of commerce and industry, just as even professional and occupational groups, exercise 'self-control' through their 'corporations' without state interference. Experience has taught them that competing interest groups may neutralize each other if they set conflicting demands to the government, and they are also aware that the law courts and government offices will reject demands running counter to public interest, or violating the legitimate principles of law and justice. Its explanation is partly found in rules assuring the legitimacy of interest group politics and partly in those cultural norms that place the state and public interests above special interests, and partly in the fact that public officials function as legitimate arbitral tribunal in assessing competing group interests. According to Edinger these pressures are able to check the political influence of even the most powerful interest groups. According to corporatist literature all this is a kind of 'guarantee' that keeps public decision-makers from being degraded to be mere means of some interest alliance or interest organization. In the ultimate analysis, control over public policy is in the hands of elected and appointed public officials.

From the above discussion, the conclusion can be drawn that corporatism should not be mixed up with statism, because it does not regard the state as a monolith institution but as a privileged part of the process of public policy, which is interpreted as the interaction of public policy actors mutually controlling each other. It is to the benefit of corporatism that it (has) argued convincingly for state institutions (public policies) being capable of satisfying the needs of civil society, whereas free associations and markets are incapable of doing so. Those needs are the public goods (legal system, defense, etc.) that can be satisfied only by a uniform authoritarian state. It has also argued that the state has to have sovereignty over all the citizens and secondary groups to be able to solve conflicts among individuals, or between individuals and secondary groups, and that its decisions must be accepted. This sovereignty, however, is not unlimited, because it is the law and the Constitution that mediates between the state and the citizen and the various associations, and limits that sovereignty.

The most frequent objection to corporatism is that it is not a universal theory but a particular one, because its validity extends over the practice of only such countries as Sweden, Austria, or Germany. Another objection is that the relationship between government and the different social groups and corporations is only one element of public policy making. Governmental activity cannot be reduced merely to this relationship. The third criticism of the theory is that it does not clearly spell out what the content of those interest groups is that are 'represented' by the state and by what criteria the state would decide in any given case about the relative merits of the objectives of different interest groups. Conservative answers to this question vary greatly: some stress that corporatism is the manifestation of the concept of the autonomous state in the service of promoting social change; others emphasize that the state itself is a system considered desirable by the most powerful corporate actors of civil society itself, because they can only realize their objectives through its mediation.

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# Chapter 3





# **Dimensions of Public Policy: Values, Processes, Implementation, and Results**

*Martin Potůček and László Vass*

Public policy has many dimensions. In this chapter we look at a number of them. We begin with normative dimensions of public policy: the importance of values that underlie policy choices. We consider human rights, political and social rights, and the role of ideology in public policy as a social practice. Important to normative dimensions of public policy is one's view of the capacity of human intellect. Looking at those different assumptions, the chapter explores several normative models such as utilitarianism, Rawl's principle of justice, and others. With this foundation, the chapter then turns to the question to the process of policy – how the various stages of policymaking have been conceptualized. Finally, we examine models that focus on the later stages of policymaking – the implementation and realization of policies and the outcome of policies. Were they carried out as intended and did they have an effect on society?

There exists a number of social philosophies, while there are even more practised public policies. Not only does every society have its own historical experience, cultural tradition, belief systems and institutions, but within each society there is also an on-going battle, either hidden or obvious, between various ideas and concepts of the common good and the public interest. Conflicts about “choice of society” (Roebroek) occur regarding issues such as the direction and the nature of society's basic orientation, which can then find its voice in various forms of law, public administration, the understanding of, and adherence to, human rights, and so on.

Public policy as a social practice nevertheless needs some sort of basis for its criteria, which would simplify communication on what is still, and what is no longer, the common good or the public interest. There is a need for something that would give meaning to the varied choices that are put before both the common citizen and the politician, which could even ultimately guide them through crucial situations in which they find themselves on a daily basis.

Contemporary societies are thus characterised by a plurality of opinions on what is or is not proper and desired, and we have many reasons to believe that it is this very plurality which brings the necessary scope of possible choices and adaptability in difficult situations. On the other hand, every society needs a specific common denominator, a kind of collective core criteria, which the broad majority of its members respect and share. Otherwise it is threatened by disintegration and collapse.

## **Values**

Shared values have been a part of human behavior since time immemorial. Those hunters and gathers who lived thirty thousand years ago observed the basic funda-

mentals of behavior that regulated their methods of resolving everyday situations: The search for food, movement of individuals, protection against nature's influences and external dangers, as well as sexual and family life. Later, a written codification (albeit not always explicitly stated) of these rules and values also appeared: The Chamurapi law, the scriptures, Talmud and Bible. Europe was influenced by the development of values that originated from the time of the Mesopotamian culture, and which were passed down through the subsequent periods of antiquity, Christianity, the enlightenment to finally the modern age.

When researching of the relationship of people's values to the market, government and the civic sector we will resist narrowing our view to only a few key values. By this we have in mind the extensively discussed values of **freedom, equality and human rights** that have recently emerged. "Theorists of the "New Right" such as Nozick (1974), the Friedmanns (1980) and Hayek (1976) defended the view that freedom and equality are incompatible:

*"As long as the belief in 'social justice' determines political actions, then this process inevitably brings us ever closer towards a totalitarian system."  
(Hayek, 1976: 68n)*

This viewpoint has been fundamentally rejected by "egalitarian theorists" who maintain that the values of freedom and equality are indeed compatible.<sup>1</sup>

In recent times, the problem of socially conditioned possibilities for the development of the individual has been addressed by theorists such as Sen. In order to be able to understand those (as yet unravelled) human capabilities it is necessary to differentiate between negative and positive freedom (sensu Isaiah Berlin). The negative concept of freedom concentrates only on the absence of barriers by which one individual (or institution) constrains another. The positive concept of freedom is interested in what a particular person can or cannot achieve:

*"Should we consider that it is important for a person to be able to live life according to his or her own choices, then the general concept to which we must address ourselves is that of positive freedom." (Sen 1990: 49).*

Positive freedom is defined as a broad spectrum of possible choices:

*"It is quite possible that an illiterate person who had been taught to read would nevertheless decide to read nothing. . . . It is a fact that a great many people do things that others do not do. Nevertheless the fact that sometimes they choose the same thing with an equivalent benefit does not, because of this, make it irrelevant." (Sen 1984)*

Theorists using the concept of human resources attempt to understand the complexity and mutual conditioning of human, economic and social development:

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1 See, for example, Lukes (1992).

*The evolution of human beings into the form of educated, motivated, healthy and well-fed individuals is not merely a final goal, but also a necessary condition of productive work and economic development.”*  
(Streeten 1989: 74)

## **Human rights**

In comparison with the middle ages, the modern age, inspired by the enlightenment and liberalism, marked a fundamental return to the recognition of the universality of human rights. The concept of human rights that by the 20th century had begun to be used with more frequency has its ancestry in the concept of natural rights. The first theorists of natural rights such as Grotius, Hobbes and Locke, emphasised in particular the right to freedom and property. The concept of natural rights was first incorporated into political documents in 1776, when American Declaration of Independence stated:

*“We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.”,*

while the French Declaration of the Rights of Man of 1789 spoke of inherent, unalienable and irrevocable rights. We should remind ourselves of the slogan of the French revolution “Liberty, Equality, Brotherhood”. From here there is a direct link to a host of declarations of human rights, the most significant of these being the Universal Declaration of Human Rights, adopted by the General Assembly of the UN in December 1948.

This turn-around meant not only a change of view in the status of the individual in society: for the school of thought that placed emphasis on liberal freedoms in particular, it also laid the foundations for the evolution of democratic political systems and public policy. It also freed up unsuspected room for the introduction of the market, as well as an unprecedented blossoming of the economic sphere. On the other hand however, it opened the way for the emergence of totalitarian movements who, in the name of securing equality, succeeded in temporarily subjugating complete national societies.

Human rights can, of course, also be transported and defined according to those human needs that are perceived and recognised as fundamental. Marshall (1963) offers the following explanation for the evolution of modern states: There exists an elementary form of human equality, linked to the full participation of the individual in the life of a community. This equality is not incompatible with economic inequality. It is therefore necessary to broaden the concept of the rights of the citizen in such a way as to include three components – civil rights, political rights and social rights. **Civil rights** are connected to individual freedom – the protection of the personality, freedom of speech, thought and expression, the right to own property and conclude business agreements, and the right to justice, guaranteed

by an independent judiciary. **Political rights** allow the individual to share in the functioning and execution of political power, either in the form of voting one's own deputy to the organs of political power, or where the citizen himself has the right to be elected to these bodies. **Social rights** represent the right to share in the use of a given society's social inheritance, and the right to live in dignity i. e. to live on a level corresponding to the standards prevalent in that society. Marshal claims that while civil rights were formulated in the 18th century and political rights in the 19th century, the 20th century has seen the formulation of social rights.

### **Ideology**

Public policy as a social practice needs to be anchored in some kind of criteria which would simplify communication on what still is and is no longer the public good or the public interest, which would give meaning to varied choices that are put before both the common citizen and the politician, and which would act as a guide when they find themselves faced with decisive or important situations, which occur on a daily basis. We should thus ask ourselves the question – what sort of comprehensive value systems are at our disposition?

There are political ideologies which, together with human values, significantly influence decision making in public policy. These are relatively common and comprehensive interpretations of society's problems and the possible means for resolving them, which are weighed according to differentiated social interests of various groups of citizens. At the same time, however, they also include to a certain extent that which would be referred to as the interests of communities or societies as a whole i. e. public interests.

Ideologies are a necessary component of communication in political discourse. They facilitate an identification of political stand-points and priorities. However, they are at the same time a framework that significantly simplifies the understanding and interpretation of social realities. As such, they are a potential instrument of both misunderstanding, as well as justification for the decisions and acts of the unreasonable and irrational, when faced with a problematic situation. It is in this situation that the advantages of the pluralistic political process, by allowing the possibility of a free exchange of opinions and a range of political preferences, demonstrate themselves, while also allowing for the identification of misleading or deforming elements which had previously not been perceived by its supporters.

Also, it is here where space opens up for making changes and corrections to existing ideologies that have been made necessary by the emergence of new and previously unknown problems. A state may thus find itself faced with a newly defined task such as the battle against international terrorism, while non-profit organisations prick our consciences and arouse our sense of self-preservation regarding the growing negative influence of man on the environment, etc.

### **Normative models of public policy**

Lindblom (1977) characterises the schism of modern social thought by two models/concepts of public policy:

*Model 1:* The society ordered by reason. This is based on an optimistic assumption of humanity's capacity to act reasonably. (This draws heavily on the enlightened, rationalist tradition and Marxism's belief in the possibility of understanding and utilising the mechanisms of societal motion.) This model is run by a reasoned elite, by analysis, "science", even by the politburo and the state planning commission. Social conflict is suppressed. It answers the question "what is best for society"? The basic regulator upon which it relies is the (state) administration.

*Model 2.* Human intellect is limited, it is necessary to use other methods to run society. (It is possible to use only partial explanatory models – for example, the causes for the emergence of delinquency among adolescents. . .). The model is based on the application of human preferences, on the results of their social interactions where they substitute conclusions of analysis. This is why this model so highly values procedures of social interactions e. g. exchanges. Many interactions are perceived as a means of protecting individuals from their own errors in the building of institutions and in the creation of policy. Political and civil freedom is, among other things, an instrument for safeguarding the interactions that lead to the resolving of problems. Paradoxically, this model gives more weight to intellect and thought. It is based on the conviction that analysis is difficult, often impossible. The conflict of ideas is viewed positively: the battle of doctrines is not destructive, but rather an opportunity to reveal further facts. Problems in society are routinely resolved by this method of interactive processes that are not obvious to any of their participants. An actor enters into an interaction which resolves a problem of allocation of resources, although it is in fact a by-product of the resolving of his/her own individual problem. Initiatives leading to the resolving of problems are also supported in this model. Decision-making is extremely pluralistic and decentralised. The diversity of individuals and groups is seen as positive. The main regulator upon which it relies is the market.

Popper periodically characterises this fundamental difference as being one of closed (model 1) and open (model 2) society. According to him model 1 is unrealisable without revolutionary interference into the societal organism, while model 2 satisfies itself with gradual, partial reforms and social engineering.

It is of course possible to define even more specific models of public policy which have been inspired either by the work of some influential social philosopher, or directly from social practice. (See also Weimer and Vining 1992, Lane 1993, Popper 1994, 1995).

*Utilitarianism*

Bentham defined the goal towards which human society should direct itself as that of ensuring the maximum happiness for the maximum number of people. The overall, communal public good or happiness is the sum total of the utilities of all members of a given community. Critics of this model point out that the function of social happiness is operationalized only with difficulty. Problems occur when one attempts to measure individual utility – these utilities are rather subjective in character. As observed by Arrow (1971), one gets into numerous methodological complications related to the required aggregation of individual utilities to common utility. (The problem can be got round by measuring consumption, thus giving the utility of each member of society, or by either the amount of consumption of goods by individual persons or the by the size of wealth and incomes which individuals have at their disposal for the purchase of goods according to their choice.)

*Rawl principle of justice*

In a critical reaction to utilitarianism Rawls (1995) attempted to define a more specific criterion: it is necessary to maximise the advantages of the least preferred, based on the assumption that such living conditions are, at the very least, provided to the most handicapped individual as they are to all. Technically this means that systems of redistribution should be implemented right up to moment when the motivational system would be endangered to such an extent that (in regard to an overall decline in production) it would even worsen the standing of the most handicapped individual.

*Neoliberalism (libertinism)*

Some thinkers (especially Nozick 1974) argue that the best, and in fact almost exclusive, method of achieving happiness in the social organism is to allow complete freedom of operation of market mechanisms. The self-regulatory power of the market can bring society to its desired flourishing; only the market is thus capable of safeguarding economical effectiveness. The state, on the other hand, makes people less free, it prevents them from finding their own way towards happiness and wealth. In other words, it is necessary to reduce the function of the state to the bare necessary minimum. (paraphrased by the expression “the state as an ever-vigilant guardian of the citizens’ peaceful slumber.”)

*Absolute equalitarianism*

The Khmer Rouge at the end attempted to realise their own vision of a state in which everyone would be completely equal, and where the market mechanism would not exist. During the realisation of this vision they were more consistent than the representatives of contemporary totalitarian regimes in other countries. Hundreds of thousands of Cambodians paid for this experiment with their lives.

*The maintenance of institutional values – Conservatism*

Traditionalists are convinced that rather than to go looking for an optimal distribution of resources, it is better to gamble on the workings of proven social, economic and political institutions, and the laws by which the required distribution will unravel itself. Among the most important of these belong the institutions of the constitution, civil and political rights, the family, the church and the state. Significant importance is attached to social values, norms, conventions and other informal forces (e. g. social control) which influence interactions between members of society.

*Reducing inequality*

Supporters of this model draw attention to the fact that there are two undesirable aspects to the functioning of market relations. On the one hand, the market does not concern itself with the type of resource used by individuals to assert themselves (be it inherited financial resources, intellectual or physical resources, their state of health or social background), nor is it sensitive to the specific needs of the individual. Thus it occurs that, under otherwise similar circumstances, some people are endowed with large resources while others lack the resources to satisfy their basic needs. The additional argument of this model's supporters is based on the assumption of a shrinking marginal utility set against growing wealth. Thus, the richer people become, the less marginal utility they receive for the same amount of money. The same unit of wealth would cause the poor to be happier. Should this be the case, then the more equally the given amount of resources is distributed, the higher the value of the function of social happiness will be. It is therefore necessary to supplement the market with a re-distribution of resources through taxation, public budgets and services.

*The criterion of human dignity*

Popper (1994, 1995) formulates a basic hypothesis of this model thus: It is in a person's make-up that is not possible to ensure happiness for himself, but he can nevertheless safeguard dignified conditions for living. This concept thus contains as its goal for societal evolution the maximum removal of human unhappiness and suffering, rather than the maximisation of happiness for the maximum number of people. Each person has its own inner values which derive more from the fact that he/she is a human being than the fact that he/she contributes to society's well-being. A component of this dignity is the possibility of choosing one's own life (at least within certain boundaries). As another supporter of this model, Sen (1984, 1990), observes, the concept of dignified survival is a relative one which is tied in with concrete cultural and economic realities of a given country.

*Cultivation and utilization of human potential*

Advocates of this model base their views on the premise that even if people are not born with the same dispositions and inclinations, it is possible to provide everyone with an even chance of developing and utilizing their dispositions – in

other words, it is necessary to provide a guarantee of equality of opportunity. This understanding of freedom does not conflict with the principle of liberalism which states that it is impossible for society to achieve prosperity if it does not benefit the individual. What it does recognise however, is that in a society run along market principles, not every individual has an even chance of personal development – and that it is in society’s interest to create for these individuals acceptable conditions. At the same time no-one can be forced to take advantage of these conditions, but each will be given an even chance. (For more details, see Addo 1986, Potůček 1991, 1992, Streeten 1989)

### *The sustainable development*

While all the previous models have been based around the human conditions, this model focuses on life in its complexity. It is thus not solely concentrated on the life of the human race alone, but rather it looks at all living creatures on planet Earth. It has its origins in the teachings of Schweitzer which emphasise respect for life and reflect on new global threats that stand before mankind as a whole.

*“It is aimed towards the search for harmony between man and nature, between society and its environment, in order that we should to bring ourselves as close as possible to the ideals of humanism and respect for life and nature, in all its forms as well as in its various time spans.”*  
(Vavroušek 1993)

Even though it is possible only with some of these models to state that they have, in some form or another, been applied practically, at the very least all of them have influenced the perceptions of citizens as well as politicians in the never-ending discussion concerning the desired goals for society’s evolution and development.

Even though individual normative models of public policy (as well as the criteria by which they are used) can seem rather general and discussion on them thus somewhat academic, the truth is quite the opposite. These models can have and do have a large practical impact on the selection of instruments for public policy as well as on the formation and realisation of concrete public policies in their specific field.

Normative models are only one kind of model of public policy. Also important is the process of making policies and the environment in which they are made.

## **The Policy Process and its Environment**

### *Different Definitions of Public Policy*

Public policy is one of the most frequently used phrase in discussions about public administration, governance or interest articulation. In spite of the professional importance of this expression, public policy is far from being well defined. It is a very complex and complicated phenomenon, that can be approached from many



different directions. Hogwood and Gunn (1984) collected the most common interpretations and characteristics of public policy in the policy literature.

#### Interpretations of public policy

- as label for field of activity
- as an expression of general purpose or desired state of affairs
- as specific proposals
- as decisions of government
- as formal authorization
- as a program
- as output
- as outcome
- as a theory or model
- as process.

#### Characteristics of public policy

- policy is to be distinguished from 'decision'
- policy is less readily distinguishable from 'administration'
- policy involves inaction as well as action
- policies have outcomes which may or may not have been foreseen
- policy is a purposive course of action but purposes may be defined retrospectively
- policy arises from a process over time
- policy involves intra- and inter-organizational relationships
- public policy involves a key, but not exclusive, role for public agencies
- policy is subjectively defined.

Public policy in practice is a process, including a complex array of actors and interactions inside and around it. The process as a policy framework has very important advantages. First, it suggests that public policy is dynamic. Secondly, such a framework is flexible, showing that the actors and activities are changing over time and space. Thirdly, it is a useful tool for analyzing the interactive nature of policy activities and operations.

The *systems approach* outlined by David Easton has been a generally accepted model for policy analysis for long time (1953). Easton argued that political activity can be analyzed in terms of a system containing a number of processes which must remain in balance if the activity is to survive. The paradigm that Easton employed is the biological system, whose life processes interact with each other and with the environment to produce a changing but stable bodily state. Political systems are like biological systems, argued Easton, and exist in an environment which contains a variety of other systems, including economic, social, and cultural systems. (Easton, 1953.)

The policy-making process involves many sub-processes and necessarily extends over a certain period of time. The objectives and purposes of a policy are usually defined at the start of the policy process, but these may change over time and,

in some cases, may be defined only retrospectively. The outputs and outcomes of policies do not necessarily represent the end of the policy process, on the contrary they may give good reason for the prolongation of the policy process.

Policy analysts outline different analytical frameworks for studying the policy process. There are approaches specifying four to nine stages of the policy process, put stress on different parts of the whole process. A relatively more integrated model was proposed by Jenkins (see in Hill, 1997. p. 23.) with seven stages:

1. Initiation
2. Information
3. Consideration
4. Decision
5. Implementation
6. Evaluation
7. Termination

This model suggests that the policy process is a progressive actualization of policy in a visible and explicit way, which is not the case in most time. An alternative, more “fine-tuned” division is defined by Hogwood and Gunn (1984):

1. Deciding to decide (issue search or agenda-setting)
2. Deciding how to decide (or issue filtration)
3. Issue definition
4. Forecasting
5. Setting objectives and priorities
6. Options analysis
7. Policy implementation, monitoring, and control
8. Evaluation and review
9. Policy maintenance, succession, or termination.

In this approach the emphasis is on the decision-making elements of the process, the most political and critical part of the policy making process. A more detailed model offers deeper sight into incremental, rational decision-making. The nine-stage framework shows better the complexity of the process and it goes beyond a simple identification of stages suggesting also the expected actions in the given stages. As far as the process model for public policy is very useful framework for analysis, the following remarks should be taken into account:

- Stage models suggest that public policy is a rational and explicit process, there are serious delimitation of rationalism (Simon, 1947) and explicit formulation in public policy. Policy process rather shows incremental development.
- Policy processes are mostly continuous processes of evolution in which starting point may be in the past.
- Policy initiation may start anywhere in the political system.
- Stages do not mean that a particular policy necessarily formulates on a unified, predictable way.

- Stages (actors and activities) may overlap and feedback loops may be between them.

For studying the policy process, – not forgetting the remarks in the previous paragraph – a simplified stage framework can be a powerful tool. The most accepted model of the policy process is a four-stage model:

Agenda setting	Formulation	Implementation	Evaluation
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Although the model has been developed in West, these stages can be identified in the Central and Eastern European and other post-communist countries as well.

### *Actors in Policy Process*

Policy making generally is a process which involves elected politicians, appointed civil servants and representatives of pressure groups who are able to get in on the action. In the study of policy processes, there has been a long-standing concern to define appropriate roles for the various actors. In the post-communist environment, the most important characteristic of the policy process is its over-politicized nature. Because of this, the politico-administrative relations play a decisive role in forming the position of actors and authorities in the policy process.

“Politico-administrative relationships start with a tricky question: ‘Who rules?’” (Rabrenovic’, 2001) The formal answer is quite simple: both officials and politicians rule. (Page, 1992) Aberbach and Rockman (1998), however, distinguish between formal and informal rule. From an official point of view, the answer is ‘politicians’. However, if one views the issue from a more informal perspective, things are not that clear. It is obvious, that politicians naturally expect to make important policy decisions when they come into office. They may soon recognize that without administrators they cannot operate. In this relationship, bureaucrats definitely have influence on the policy process. In spite of the difficulties concerning the “who rules” question, many theorists continue searching for an answer, concentrating on formal rules that guide the behavior of politicians and bureaucrats in the policy process. The study of the policy process requires an understanding of behavior, especially behavior involving interaction within and among organizational memberships. For a policy to be regarded as a ‘public policy’ it must to some degree have been generated or at least processed within the framework of governmental procedures, influences and organizations.

Fighting with the Communist legacy overvalued the importance of establishing the “rule of law”. This issue refers to the old question of the separation of politics and administration as well as the Wilson’s dichotomy and the Weberian concept of bureaucracy.

*“The concept of politics-administration dichotomy is one of the most contentious notions in the theory of public administration. The origins*

*of this concept, its practical existence and general desirability have been discussed for a long time. From its first appearance until now, the concept of politics-administration dichotomy has had its strong presence in academic literature, being highly praised and forcefully disputed. Notwithstanding the constant challenges, the advocates of the theory of politics-administration dichotomy, however, managed to catch their breath, with the theory becoming one of the few surviving public administration myths.” (Rabrenovic, 2001.)*

The ‘rational model’ suggests politicians making the value choices, forming ‘premises’ for the more detailed decision processes to be carried out by officials. Wilson’s dichotomy which tried to delineate the respective territories of ‘politics’ and ‘administration’, may be seen as to some extent an attempt to draw a distinction between the ‘policy decision’ and ‘implementation’. Wilson’s dichotomy has been widely attacked, not so much for its prescriptive aspirations, as for its impact upon the way policy processes are described. It is seen as a ‘hindrance to accurate scholarship’. It is important to observe how often politicians or administrators are involved in the policy process on the ‘wrong’ side of the boundary in Wilson’s dichotomy. In fact, permanent officials are almost universally involved in the preparation of policy, while politicians’ need to be responsive to the problems faced by their electors leads them often to take an intense interest in the implementation process.

Besides politicians and civil servants, corporatist and civil organizations are also playing significant role in the policy process. In some Central and Eastern European political systems a neo-corporatism has been emerged with changing influence of the unions and employers’ groups. (Potůček, 1999; Cox – Vass, 2000.) Professional associations are also active contributors in the policy process. Nevertheless, civil organizations are rarely strong in the CEE countries, therefore their influence on the policies is rather incidental. As a consequence, policy communities or issue networks are in very immature stage in this part of the world.

A more balanced power-relation and more rapid development of the civil actors needed for approaching that “the ideal picture of the policy process in democracies is one where there is a continuous, dynamic interaction between the government, public administration, populace and institutions of civil society.” (Grochowski – Ben – Gera, 2002. p. 24.)

### **Public Policy Making and Implementation**

Implementation of a particular policy addresses everything that is somehow connected with the actualization of objectives formed in the phase of drawing up that policy. This includes evaluating the scope of these objectives and selecting the means, methods, and respective instruments best suited for their actualization. The term ‘policy implementation’ can also of course be used for labeling an individual process that brings policies into being and ensures their application.

Implementation will be discussed here in its first sense, i. e. a process of realizing formulated policies at the time when it has already been more or less decided what should happen, and also how it should be achieved. Of course, it is almost impossible to separate out stages of policy formulation and implementation. Dictatorships would possibly come the closest to having this ability, but nevertheless not even they can completely ignore what is said to be the feasibility of a policy. The singling out of the process of implementation from the overall process of formulating and realizing policies has therefore suffered repeated criticism, even by those authors who were at first pioneers in establishing this concept.

Four theoretical models of implementation have been proposed:

- The *authoritative model*, emphasizing such instruments as directive instructions, planning, control, hierarchy and accountability.
- The *participative model*, relying more on indirect instruments of control such as setting goals, spontaneity, training, adaptation, negotiation, cooperation and trust as suitable methods and conditions of implementation;
- The *coalition of actors model*, resulting from the assumption of a plurality of actors, who participate in the actualization of a particular policy and who communicate between one another, negotiate, reach compromises, but who at the same time share a definite common set of values and who are striving to achieve the same objectives;
- The *endless learning model*, where those who enact policy, in an effort to achieve an optimal solution gradually (often by making use of the method of trial and error or by sheer imitation), optimize the structure of their objectives and the techniques used to achieve them.

People who, in practice, are responsible for the realization of a particular policy sometimes have a tendency to overvalue the importance of an individual decision (be it legislative, administrative or economic) preceding the policy's realization. Experience tells us that there is often a long journey between the making of a decision and its actual realization, in the course of which many, often unforeseen, complications occur. Furthermore, the initial concept of what is desired changes and with this the necessity of certain policies.

When considering the implementation of a given policy, we can also assess which of the normative models of public policy should be the vehicle for its realisation. The weighty, extraordinarily difficult, but nevertheless important choice of which regulatory instrument, or combination of regulators (the market, government, responsibility of civil actors) adequately responds to the requirements of the relevant policy is then made. Nor can one disregard the assessment of a policy's feasibility, i. e. whether it is a suitable moment for the actualization of the particular policy (the existence or non-existence of an opportunity window), what the possible public reaction will be and what effect the chosen approach will have upon various sectional interests and public opinion in general.

Some authors go so far in their statements as to declare that no policy whatsoever has a chance of coming into being. In saying this they expose the basic problems of policy implementation in a society:

- The autonomy of societal development versus the efforts to influence, in some way, that development. Society's development can be influenced, but it is only with difficulty that we can talk of its "controllability". If we accept this position, there then emerges in the formation of policies, and even more so in the case of implementation, the problem of a specific area where autarchic development of society is at least partly possible to influence.
- Growing complexity of the environment in which we live, which makes it even more difficult to identify all necessary preconditions of a successful policy implementation.
- The considerable momentum (path dependency) of value orientations, attitudes, and the behavior of both people and institutions (in the case of organizations, the interests of their members fixed on their survival).
- No policy is realized in isolation. With it tens, possible hundreds of other policies are also realized. This situation is sometimes seen as a parallelogram of policies and the strengths of the actors involved. Along with this comes the typical interfering, conflicts, consonance with inevitable unexpected consequences.
- The difficulty in anticipating future developments and the limited possibilities of preparing for them in advance.
- The problem of policy simulation: There is sometimes an intentional falsehood in a policy which pretends that particular policies have come into effect and gives them symbolic support even though the true interests of the executors of policy lie elsewhere.
- The problem caused by a policy's undesired consequences. The unforeseen negative influence of a policy on an area or interest can either frustrate or even discredit its implementation.

Lipsky (1980) was the first to note the importance of the conditions where policy implementation is actually being realized, i. e. at the direct point of contact between the citizen and the service provider. The high level of freedom for decision making retained by the providers who are in direct contact with ordinary people, this means that it is often their interests, attitudes and responsibilities that prove decisive in the success or failure of a policy's realization, even though the policy had actually been conceived and drawn up "from above".

Another point of interest is whether the implementation occurs within the framework of policies already in operation (this has its roots in the functioning of institutions and the behavior of individuals – "muddle through" in the sense suggested by Lindblom) or if it introduces some important innovations, fundamental reforms or basic changes to the course of society's life and thus to those conditions that satisfy the interests of both the citizen as well as particular institutions.

The so-called implementation deficit is often referred to in literature. The basis of this disparity is the belief that once a formulated and accepted policy somehow

achieves its objectives automatically, policy is easily realized. The implementation deficit can be expressed as the disparity between the disposable capacities for the actual realization of a policy set against the capacities which would have had to have been invested in order to achieve the desired goal.

Ordinary people are by and large not initiators of policies. Their position can be divided between the two extremes of total indifference on the one hand and direct participation in implementation on the other. Where the citizen sits on this demarcated scale is therefore of some importance for the success of many policies. Implementation is also about how a particular policy is accepted on its own terms, as well by whom and when.

Apart from the intentional actions of their individual members, the behavior of collective actors also depends on their ability to organize themselves, as well as on their contribution to a particular policy in term of disposable resources and responsibility. Collective actors also play an important role in influencing individual behavior by formulating stimuli for actions and also stabilizing expectations.

When considering the role of differentiated actors in the implementation process, one should at the very least take into account:

- Their “understanding of the world”, their ideologies, the frames of reference used by them for interpreting social realities.
- Their behavior, values, motivations and interest structures.
- Their resources – intellectual, financial and organizational.

A point to note is how many actors participate in the implementation of a particular policy. As their numbers increase, so exponentially does the likelihood of conflicts of interests occurring, and with this the need for drawn out negotiations, the formation of functioning coalitions etc. This is where the theory and methodology of conflict resolution, a new, living and developing discipline, can be applied.

If policy is being realized within the framework or through the medium of a single institution, the situation is more straightforward than if it had to be realized throughout a whole sector. The most complex situation arises if a policy intervenes across a total functional sphere of society (e. g. unemployment), or a whole society (e. g. a program of drug abuse prevention).

Policy implementation can be prepared methodologically through the formulation of scenarios for the implementation process. These scenarios are made up of a description of the motivations, the frames of reference, and resources of those groups targeted by the implementation, as well as the internal conditions necessary for policy realization. The timing of the implementation, and the problem thrown up by it, can be separated out into two dimensions:

- Short-term versus long-term implementation of a policy (this is connected to whether implementation ties into the operative, tactical or strategic level of the policy)

- The connectivity or non-connectivity of the policy process. Where a policy falls into the latter category, the timing of individual actions becomes important both from the viewpoint of a suitable starting point as well as from its consequential effect. The decision on the timing a policy's realization is conditioned by how well informed those implementing the policy are regarding the conditions for its actualization. These conditions can be both objective and subjective in nature.

A necessary condition for the effective implementation of any policy is the existence of a coordinator for the implementation process. The role of such a coordinator, apart from policy realization, would be to silence any conflicts of interests that might arise, support the concluding of agreements between the participating actors and evaluate policy application.

### **Coordination of Policy Processes**

The reform of policy-making and implementation structures and systems is one of the most difficult elements of the administrative development process, even more so in the specific historical context in Central and Eastern Europe. The policy-making and implementation processes still show many features of the previous systems: top heavy co-ordination, leaving little or no space for conflict resolution before issues reach the government, duplication of functions (especially in the legislative process) and a lack of clearly defined accountability structures. Even in new states, such as the Baltic States, the division of labor between ministries and the core executive unit in the policy process still shows some of the features of the former system. (Verheijen, 2000.)

The formal picture of national policy making mirrors conventional thinking about how policy processes work. Policy preparation is presumed to work according to a top-down model in which politicians make decisions which are elaborated in more detail by officials. Administrative action is programmed in line with political priorities. This model assumes that governments are monolithic systems with unified political leadership.

*"It puts the main emphasis on defining structures, especially top-level structures, while assuming that there are adequate capacities, and the appropriate processes to manage policy preparation within them. Often, as discussed later, these assumptions are not justified. The top-down model makes the designation of a particular part of government as "the coordinator" the crucial issue." (Metcalf, 1996. p. 31.)*

The central control model of coordination in the CEE countries pays too little attention to the contributions of horizontal coordination between ministries. There is an inherent suspicion of the willingness and ability of functional ministries to coordinate with each other. But in practice the effectiveness of a coordination system depends enormously on "coordination without a coordinator". That is direct, often informal, horizontal coordination without a central coordinator to supervise



what is happening. If these capacities are inadequately provided, and functional ministries cannot share the workload of preparation and coordination, too much will fall on top level coordinating institutions, which will soon be overloaded and clogged with large numbers of problems which require detailed decisions. Thus the structural approach runs the risk of over-centralization and slow responses. This is an important weakness because especially international policymaking can often require quick responses. The pace of change and the timing of decisions are not so much under national control as they are with domestic decisions.

As Metcalfe said, another problem is the difficulty of agreeing where coordinating authority should be located. At the political level, presidents, prime ministers and cabinets also claim a role, and economics and finance ministries are invariably involved. If they each press their claims to try to establish dominance, disagreements about where responsibility for coordination should be placed may degenerate into a bureaucratic power struggle. In reality, no single ministry or central institution can exercise a monopoly. Coordination cannot be simply equated with unitary central control. In a well managed system of government, there is a division of labor in coordination as well as operational responsibilities. Coordination is a collaborative process to which the expertise of functional ministries as well as the overview of central institutions contribute. Coordination is how the efforts of different parts of the system mesh with each other, rather than how one part of the system attempts to control the rest. In this perspective it is more important to consider *capacities* and *processes* for coordination rather than the more conventional emphasis on *structures*. In particular, it is important to consider the information flows required to prepare negotiating positions and strategies, and the capacities and processes required to make informed governmental decisions. Often, the required information must be acquired from a wide variety of outside sources, domestic and foreign, and then assembled and disseminated within and among ministries responsible for different facets of policy. The process of coordination is an inherent part of the successful policy making process. Coordination can provide policy coherence, what is vital for an effective and efficient governance.

### **Evaluation of Results and Policy Analysis**

The countries in Central and Eastern Europe are still undergoing a significant overhaul of their existing structures, systems and legal frameworks. Whatever the task, be it adapting to a market economy, updating social security and health systems, or preparing for EU enlargement, governments and their administrations must further develop their policy capacities and attempt to ensure that laws and programmes meet the needs of society and are effectively and efficiently designed and implemented.

*"In developing their policy capacity, the countries of Central and Eastern Europe face the challenge that improvements are still needed in all phases of the policy cycle: defining policy objectives; development of*

*policy options; elaboration of the policy instrument; implementation and evaluation.” (Improving Policy Instruments..., 2001.)*

Policy evaluation and analysis is an important tool for improving policy capacity and thereby improving the quality of political decision-making and policy instruments. In general, CEE countries have been historically lagging behind in developing their policy analysis capacity. Policy evaluation have always been a politically controlled tool in the hands of the political incumbents, and it has not changed yet too much. Governing political parties may monopolize or classify the information on policy implementation, and a good quality, non-partisan capacity for policy analysis is emerging only with great difficulties. Because of this political environment, such policy analysis, which is “in” the process might be more feasible than an independent analysis from “outside” the process. Over-politicization resulted in some post-communist countries, that the policy evaluation became a policy advocacy, and – using the terms of Hogwood and Gunn: – political actors are playing the role of the analysts, same time analysts are acting as political actors. (It is very important to recognize that the ‘analysis of policy’ is serving the understanding of policy, or the ‘analysis for policy’ is serving a better quality policy making. (Hill, 1997.)

Apart from the political factors, a very important application of the policy analysis is the impact assessment. It directly serves the better policy design as well as the more effective coordination and harmonization of the policies. There are three phases in the policy cycle where impact assessment is particularly useful:

- In the policy development phase. Once the political decision has been taken to pursue certain objectives and goals, impact assessment is used to develop policy options and to select the most appropriate policy instrument to achieve the objective.
- In the instrument development phase. Once the instrument has been chosen, impact assessment is used while drafting the instrument, to ensure that it is well-designed and will meet the given objectives in an efficient and cost-effective manner.
- In the evaluation phase (ex post evaluation). Once the instrument has been implemented for a certain time, impact assessment is used to verify the real impact; assess to which extent the objective has been met and initiate amendments/corrections, if necessary.

Building a policy analysis capacity is an important tasks for the near future in the CEE countries. It raises parallel tasks: supporting the development of the training and research capacities, which cultivate the required expertise, and establishing evaluating capacities in the public administration and using the independent capacities out of the government bureaucracy.

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# Chapter 4



# Policy Coordination: Government, Market, and the Civic Sector

*Martin Potůček*

## Introduction

Political economist Adam Smith never distinguished between economic and political analysis of institutions, interests, values, interactions, or market itself. However, the holistic approach of traditional liberal thinking suffered numerous attacks in the course of the centuries, which followed the publication of Smith's works. The 19th and 20th centuries were witness to a veritable schism: economics concentrated on the analysis of economic relationships, while political science concentrated on analyzing political processes. This evolution reflected, to a certain extent, a new trend of differentiating between scientific disciplines. On the other hand, this rift steadily led to economists' and politicians' disregard of the realities which were routine for Smith: the conjunction and interdependence of politics and economics; much that is political is economic in nature and economies are, to a large degree, also political. At the same time, individual societies significantly differ in their concept of the regulatory function of the government and the market. Mainstream political science and economics, however, have left the basic question of the role of government and the market unresolved, instead limiting themselves by analyses confined to disciplinary analytical frameworks.<sup>1</sup>

Lindblom (1977) suggests deriving an analysis of the functioning of global societies from the definitions of the following elementary politico-economic mechanisms (regulators), which influence and steer human lives and societies:

- government, the expression of political power
- the market, a medium of exchange
- education (indoctrination)<sup>2</sup>

Streeck – Schmitter (1985) state that the social sciences traditionally uphold society, the market, and government as the key mechanisms of maintaining social order. They point out, however, that this list is incomplete, adding to it another item – the association.

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<sup>1</sup> Institutional economics and public choice theory are important, but rare and not fully satisfactory exemptions.

<sup>2</sup> Typical agents of indoctrination are educational systems and mass media. Indoctrination can have a political motive (then it is often guided by a specific ideology) or economic motive (advertisement). Producers and reporters may find themselves in situations, when it is in their personal interest to give partial or biased/distorted information.

**Table 4-1**  
Models of maintaining social order

Regulative model	Regulative principle	Specialized scientific discipline
society	spontaneous solidarity	Sociology
market	competition	economics
government	hierarchical control	law, political science, public administration
associations	harmonization through organization	organizational theory, sociology of social movements

Wolfenden’s commission (The Future, 1978) suggested classifying regulators according to the following table:

**Table 4-2**  
Types of sectors regulating people’s actions

Private informal sector	Private commercial sector
Government	Civic sector (Non-profit organizations)

The advantage of the suggested classification is that it differentiates between the private informal sector (family, neighborhood, informal groups, community) and the civic sector (associations, non-profit organizations), which in other studies fall under the more general category of civil society (Archer, 1994). This difference is crucial, because it is their organizational structures, which significantly distinguish non-profit organizations from the private informal sector, at least at an elementary level of formalization.

Besides the regulators identified by Lindblom, Streeck – Schmitter and the Wolfenden commission, we should not omit another sphere which is central to ethics and social philosophy, the socio-cultural values of a given society (narrowly defined as morality, value orientations and cultural patterns of behavior pertaining to individuals, as well as entire societies).

From public policy’s standpoint, however, primarily three of the previously discussed regulators stand out: the market, government, and civic sector. Therefore, the following chapter is dedicated to illustrating the role of the market, government, and the civic sector as elementary politico-economic mechanisms, functioning in democratic societies with market economies. This is done with the recognition that in forming and implementing public policy, the key is to understand the advantages as well as the failures of the market, government, and civic



sector, and thus to be able to identify the fields of their potential interference and conflict, as well as synergy and mutually supportive application. In short, the art of public policy making is to find an appropriate balance in their roles as regulators of public affairs.

A problem thus conceived, has contemporary relevance in comprehending processes, which have been taking place throughout Central and Eastern Europe since 1989. It concerns such politically sensitive issues as democratization of political systems, reform of public administration, the transition to a market economy (incl. privatization), the fertile conditions for the rise of corruption and mafia activities, and the birth and functioning of a civil society. The study *Not Only the Market* (Potůček 1999) uses this theoretical framework to explain these processes, taking the case of Czech Republic as *pars pro toto* (but with some references to other post-communist countries as well).

In the following analysis, we will address the advantages and failures of the market, government, and non-profit organizations. In conclusion, we will return to certain issues that relate to the concurrent use of these regulators.

### **Market advantages and failures**

*“The market resembles fire: it is a good servant, but a cruel master.”*

The market is a self-regulating system in which supply and demand, profit and loss allocate scarce resources (goods) more effectively than any other known regulative mechanism. The market mechanism is based on a voluntary agreement, between seller and buyer, about the exchange of rare resources. Balanced price systems, which regulate both production and consumption, are created on the basis of millions of such exchanges.

Prices generated by the market are signals, used by people as guides to maximizing individual profit for the minimum expenditure of resources at their disposal. Regulation by means of the market, therefore, is derived from the assumption that individuals attempt to maximize their own gain, to the extent that the market makes it possible. The individual (institution) only pursues his own egocentric interests. According to Adam Smith’s theory, the magic of the “Invisible Hand” of the market rests in the belief that collective satisfaction is reached primarily through the pursuit of purely selfish interests and that society profits from the egocentric behavior of individuals engaged in the market transactions.

From the standpoint of political science, the exchange of goods in the market is an independent form of regulation, behavioral control, and cooperation among people. From the standpoint of economics, it is irrefutable that supply and demand as well as profit and loss, allocate scarce resources (while respecting given restrictions) more effectively than any alternative regulative mechanism (Barry, 1987). The market is, therefore, the best engine, instigator, and agent of economic growth.

The functioning of the market is based on voluntary exchange agreements between buyer and seller. The ideal model of a market economy is a balanced model. In the uncomplicated world of the market, with a perfectly competitive environment, prices evolve which distribute the input of firms and goods sold by buyers so that no another such combination of inputs and outputs can be found, which would increase the profit of at least one of the participants of market exchange without decreasing someone else's profit. This maximizes the sum of the attainable wealth of a society. At the same time, the prices of inputs and outputs of production and consumption are such that the supply of all goods is equal to their demand. Economists refer to such a distribution as being Pareto efficient.

This distribution, however, is neutral in relation to the distribution of wealth among individual actors of exchange. In other words, it doesn't reflect the total wealth distribution between members of a given society. Therefore, were the market to be given free reign, the circular and cumulative processes brought about by repeated offer and demand would make those who already have a large amount of resources at their disposal even wealthier, and the poor would lose even the modest amount with which they entered the market (Myrdal, 1968).<sup>3</sup> Barry (ibid.) observes that among the effects caused by the long-term functioning of a free market unchecked by outside regulators, are unemployment and over consumption.

The market depends on the government and political power: laws guarantee personal freedoms (including the right to freely engage in market relationships) and protect private property. Rule of law backed by the state is, therefore, a precondition for effective market exchange. A functioning market also requires certain values and norms shared by all participants of exchange, including a considerable amount of trust. The combination of the above makes a type of social "capsule",

*"(which) is (. . .) best understood as an interconnected set of normative, social, and governmental mechanisms, each with a distinct function, but which can also stand-in for each other, within certain bounds" (Etzioni 1988).*

The advantages and failures of the market as a regulator of social interactions will now be analyzed in greater detail.

### *Market advantages*

*"The market (. . .) is a general system of horizontal relationships between free and equal individuals. It is an arena where people freely choose, where they enter into voluntary contracts with each other and, thanks to this, realize their wishes, desires, needs, and preferences" (Klaus, 1996: 304).*

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<sup>3</sup> This trait of the free market is sometimes called the centrifugal effect of the market: the wealthy push towards the center while the poor are repulsed to the periphery.

The market provides a tremendous amount of information about what people wish to gain and what is offered to them, and through prices, coordinates the supply of these goods and their demand in the activities of a great number of actors.

The advantages of the market, in comparison to government, include:

- the ability to maximize economic effectiveness
- a tendency to innovate
- rapid adjustment to changing conditions
- swift repetition of successful experiments
- the ability to abandon obsolete activities
- more effective performance of complex tasks
- creations of opportunities for the productive use of human inventiveness and entrepreneurialship.

### *Market failures*

If no other criteria than that of maximizing global economic effectiveness applied, and an ideal market environment existed, it would be sensible to aspire to reach Pareto efficiency, which would mean giving free reign to the market. Nevertheless:

- in politics, economic efficiency is not the only criteria applied;
- economic reality never entirely reflects the ideal of a purely competitive market.

### *Failures of the market using criteria other than economic effectiveness.*

Five separate criteria, which are derived from various normative models of society and are alive in current societies, will be considered:

- reducing inequalities in the distribution of wealth caused by the market forces
- maintaining institutional values
- maintaining human dignity
- cultivation and utilization of human potential
- maintaining sustainable development.

If these criteria are applied, then the market cannot entirely or even predominantly regulate the activities of social actors.

Those failures of the market as regulator, which stem from the existence of a market environment that doesn't reflect the ideal model of a market economy and therefore, appear even when criterion of economic efficiency is used, will now be discussed. The first to call attention to these failures was Arrow at the end of the 1960's.

*Economic theory analyzes several typical situations where the hypothesis of an ideal market environment does not materialize:*

The existence of public goods<sup>4</sup>

Private goods are defined by absolute rivalry of consumption (that which is consumed by one, cannot be consumed by another) and by their exclusion from ownership and use: a specific individual has exclusive ownership of a given good.<sup>5</sup> Public goods are, in contrast, characteristically non-rivalous in consumption (non-excludable from consumption) and/or non-transferable to a specific owner or user. Therefore, they cannot be optimally allocated using the market allocation. An example of a public good is national defense.

The existence of externalities

Externalities are defined as any negative or positive consequence (expenditure or profit), resulting from a market contract (concerning either production or consumption), which is transferred to someone who does not enter into the market relationship in question.

Natural monopoly of supply and demand

A monopoly on the part of a supplier occurs when fixed production costs are high in comparison to variable costs, so that the average price decreases with the increase in the demanded production. Provided these conditions are met, it is possible for only one firm to produce the given good for a lower price than anyone else on the market. Also a market relationship distortion characterized by a single buyer (monopsonist) exists.

Informational asymmetry between seller and buyer

Informational asymmetry between seller and buyer occurs when the quality of the goods and services, which are the object of the transaction, become apparent only during or after they have been consumed.

We can distinguish between three types of goods:

- those whose quality is known before consumption (the majority of consumer goods)
- those whose quality becomes apparent only during consumption (most human services)
- those whose quality becomes evident only after consumption (most medical services)

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<sup>4</sup> The border between public and private goods has not been determined once and for all, it can change with time. It is influenced by new technology, social situations, people's values, even political decisions (Mishan 1981).

<sup>5</sup> The right to exclude from ownership or use has two aspects: physical and legal. The legal aspect is referred to as ownership rights.

With the second and third types of goods, there is a danger that the seller will misuse his informational advantage to gain an undeserved profit; on the part of the buyer, the value of trust in the seller is increased (Arrow 1974).

The changing preferences of the market contractors.

The ideal model of market economics assumes that the participating actors have constant preferences expressed by the relationship between their capacity to consume and the expected profit. It is evident that in many situations, preferences can be changed. (For example, influencing the demand for drugs.) Such efforts are mainly motivated by the desire to remove all possible negative externalities of one's actions.

Neglecting the future.

The market reacts only to present interests, it is "myopic" and can provide the incentive to maximize short-term profits even if it means long-term losses. Manufacturers struggle to reach rapid return on invested capital; possible long-term consequences of a specific product and its consumption's effects on the fate of people are not taken into consideration.

Many other possible negative consequences of the market have been discussed besides the aforementioned failures in relevant literature. The market's lack of security and instability, negative effects of its adaptability, can cause negative social and economic effects locally as well as globally – for example, mass layoffs, bankruptcies, economic and ecological crises, etc.

### **Government Advantages and Failures**

Political power is, in contrast to the market and perhaps to indoctrination, a relatively simple means of regulation. Market regulation always requires sacrificing something in exchange for desired gain, and regulation through indoctrination requires time and systematic effort. Governmental control does not need to be costly, provided that the government can draw support from an established political power base. Understandably, establishing and maintaining power is in and of itself costly. Specific control through power must be brought about either by direct force or through an enactment of law, which must be obeyed.

The efficacy of power explains its central position in government. There are rules, delegating this power to diverse units of government. Power even enters into transactions in order to define their conditions and sometimes enters into the exchange itself. The risk associated with the government's use of political power as a regulatory device, manifests itself in the potential abuse of this power, which can exceed the original authority invested in it. The advantages and failures of the government as a regulator of human and institutional activity will now be analyzed in more detail.

#### *Advantages of the government*

Compared to the market, state authorities are more effective in:

- policy management
- administrative regulation
- rapidly mobilizing and using resources
- ensuring the continuity and stability of services
- preventing exploitation and discrimination
- ensuring public safety
- ensuring equity
- maintaining social cohesion.

Decentralization of authority and responsibility can have many advantages, which are the mirror images of the disadvantages, or failures, of highly centralized systems of government. A general advantage of decentralization is that it transfers decision making closer to the citizen. In contrast to centralized systems, a decentralized state administration is more capable of adapting to the concrete conditions and wishes of its citizens; it allows more room for experimentation and finding alternative methods of problem solving.

### *Government Failure*

Theories of government failures analyze deficiencies in electoral systems and in the aggregation of individual preferences; they describe the risk of publicly elected officials becoming estranged from the voters; they attribute problems to bureaucratic apparatuses, to the role of mass media and unregulated political lobbying in influencing political decisions; they warn of the risks posed by the predominance of organized and articulated interests of a minority over the dispersed and rarely asserted interests of the majority (and vice-versa); and they analyze the limitations of implementing collective decisions in decentralized systems of government, too<sup>6</sup> However, as far as we are aware, no one has thus far tried to systematize and synthesize these findings into a complete theoretical system similar to the one, which addresses the market failures.

If we consider the relatively broad meaning of the term government, including all of the processes that bring about the generation and use of political power (Weimer – Vining 1992), we can separate government failures into five problem areas which are related to the functioning of totalitarian political systems, direct democracies, representative democracies, decentralized systems, and the act of governing itself.

### *Failures of totalitarian political systems*

*Insufficient internal regulation.* The weakening or direct absence of feedbacks in totalitarian systems causes these systems to be unable to adequately identify changes in external conditions and budding internal problems. For this reason they react to

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<sup>6</sup> As early as 1930, Chester Barnard published a work in which he analyzed possible failures of organizations. Since then, many theoretical models and empirical analyses of government failures have emerged from the workshops of organizational sociology, institutional economy, public choice theory, public administration and public policy.

them inadequately or belatedly, if at all. This is related to the absence of feedbacks in the political system as well as in the centrally planned economy (Kameníček – Kouba 1992).

*Suppressing creative potential.* In totalitarian systems, people are not able to sufficiently exercise their dispositions and skills, which undermines the overall functioning and effectiveness of these systems, and results in a frustrated population.

### *Failures of Direct Democracy*

*The problem with referenda.* The very form of the question can influence the outcome of the vote (for example, if the question is posed in the negative, as a refusal, or in the positive, as an acceptance of the issue). It is difficult to formulate a question, which is clear, yet includes all of the important issues pertaining to the decision. The implementation of a decision arrived at through a referendum can significantly differ from the true wishes of the majority of voters.

*Unspecified majority defeats a clearly defined minority.* When a small group takes a principled and specific stance on a certain issue, yet the majority of citizens take the opposite stance, although it may be half-hearted and not representative of their specific interests, the choice of the majority prevails.

### *Failures of Representative Democracy*

*The paradox of voting.* The paradox of voting was described by Condorcet, later by Carroll, and formalized by Arrow (1966). Those who set the conditions, under which elections are to be held, have an opportunity to influence the results of the election and the success of individual candidates. Those who would not have had the chance to make their opinions heard are able to continually suggest new agendas to be decided upon. This causes an election cycle, which leads to the defeat of political coalitions, which find themselves in a state of imbalance.

*Preference intensity and bundling.* Several political issues exist which influence the decisions of voters. During an election, a candidate without a consistent and comprehensive program can win even if he did not gain the majority on a single issue, as long as he succeeded in satisfying individual groups of voters in those issues, which concern them, the most.

*The estrangement of elected representatives from their electorate.* The principal-agent theory describes the relationship between the principal, or supreme holder of power (in this case the voter), and the agent, or the actor who is delegated the authority to wield this power (in this case the elected representative). The theory points out that elected representatives may display opportunistic behavior, or behavior that doesn't necessarily reflect (and can sometimes be in direct opposition to) the wishes of the electorate. The electorate cannot easily control the behavior of the representative. This needs time and money and can never be completely effective.

*The influence of organized interests (lobbying).* Policies, which provide a small benefit to the general public, do not attract active political support because the cost of

political activism, leading to the implementation of such policies, is greater than the expected benefit. On the other hand the interests of a small, organized group have a chance of being adopted through active lobbying. Even though the policy would only benefit the given group, its costs would be dispersed throughout the entire society. Lindblom (1977) points out that this phenomenon unsuitably benefits organized economic interests in democratic political systems.

*Restricted time frame.* The decision-making time frame of politicians is mainly restricted to one, usually the current term of office. This means that not just the market, but also the government, can be myopic. In other words, during the decision-making process, the promise of short-term profit can outweigh long-term loss. This truism of democracy can be paraphrased by saying, that children and unborn citizens do not have the right to vote.

*The influence of mass media.* The role of mass media in influencing public opinion is generally recognized and systematically analyzed. The format and content of repeated information have an influence on the public's perception of public affairs. This does not have to involve purposeful manipulation; the choice of genres, agendas, and events, as well as targeting certain types of viewers, listeners or readers is sufficient. In addition, a mass indoctrination of the public via poorly regulated mass media (especially TV) is possible in democracy. This is one of the reasons for stating that the political system, for the most part, does not allow public policy to lean against responsible consideration of social costs and benefits. (Weimer – Vining 1992)

### *Typical government failures*

*Inefficiency and poor adaptability of bureaucratic apparatuses.* This government failure is explained by several mutually supportive conditions:

- difficulty in evaluating benefits, especially those of governmental activities. Exact criteria with which to assess which departments function well and which function poorly, is rarely available
- insufficient competition that would apply pressure according to the changing needs of clients, rigidity in the structure of services rendered
- binding budgetary regulations that hinder the flexibility of responses to the changing conditions of government activities.

*The estrangement of state bureaucracy from its purpose.* This government failure is caused by the difficulty in ensuring the accountability of public administration, particularly in the following relationships:

- politicians and their subordinate apparatus
- superiors and their subordinates in a bureaucracy
- citizens and the civil servants.

In all of these relationships the estrangement of the apparatus from its mission is apparent, made possible by informational asymmetry, i. e. the first subject in the relationship possesses much less information as the second subject. Due



to this condition, room is created for the misuse of informational superiority by asserting private (whether it be individual or group) interests to the detriment of the public interest.<sup>7</sup>

### *Failures of decentralized systems*

*The difficulty of governing in decentralized systems.* When it is necessary to accept and implement decisions regarding the competence of a greater number of decentralized units, decentralized systems of governance come up against a barrier created by an increased complexity of governing. Decision-making is delayed and the costs of implementing policies increase due to the need of negotiation and coordination among participating units. A reciprocal proportion is valid: the more room there is for autonomous decision making at the lower level, the less room exists for rapid and direct implementation of the decisions at a higher level.

*The threat to public interests by enforcing group interests.* Decentralization facilitates the enforcement of heterogeneous local and group interests, which attempt to “harness”, decentralized units of the state apparatus and use them for private benefit. This weakens the central government’s ability to implement comprehensive policies, and undermines its primary function as the guarantor of the public interest.

*Fiscal externalities.* Where the authority to determine the composition and extent of public budgets and taxes is significantly decentralized, decision makers at a lower level may tend to neglect the resolution of problems, which may have a negative impact on the public budgets at a higher level.

The above descriptions of government failures are derived from the analysis of concrete processes. Relevant theories, however, haven’t been sufficiently expanded to offer a definitive diagnosis of when, where, and why these failures actually occur.

### *A challenge to governmental practice*

Even the government is tackling the prevailing problem of rational choice: with limited intellectual and decision-making capacity, it is confronted by complex problems of modern civilization. Its stereotypical reaction in confronting this difficulty is to divide its problems into smaller segments, apply specialized skills to each of these separate sections, and make routine decisions by applying standard solutions developed for various categories of problems. Immediately, however, government is faced with new problems created by this approach: shortcomings in coordination, break-down in information flows, information overload of decision makers, institutional failures caused by the opportunistic behavior of administrators, and rapidly changing circumstances surrounding the chosen method of resolution. Within the governmental framework, conflicts in motives arise: political power is accepted because it brings security, expected rewards, and future benefits to administrators, nonetheless, action is expected, which may often be unpleasant. The

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<sup>7</sup> The supporters of public choice theory go so far as to assume that maximizing personal benefits, on the part of politicians and state officials, is their sole motive.

reaction to potential punishment may be pathological in the sense that individuals and institutions are taught ways in which to avoid punishment, rather than how to accomplish what is necessary (Skinner).

Many of the aforementioned government failures, however, are not fatal – we are not sentenced once and for all to coexist with such imperfect bureaucratic institutions. If Drucker (1994) is correct that life in organizations and with organizations is the destiny of contemporary people, we should not adopt a fatalistic attitude. We are definitely not witnessing ‘the death of government’. On the contrary, we need a confident, strong, and very active government. Nevertheless, we must decide between a large but impotent government and a government, which is strong because it concentrates on decision-making and influencing, leaving the administration to others. We need a government which knows how to govern, and governs. It isn’t a government, which ‘administers’; it’s a government, which truly governs.

As is stated in the conclusion of the UN Conference on Public Administration and Development, which took place in April 1996 in New York, “the resolution of the pressing problems of our time does not reside in the restriction of the government, but in the creation of better functioning government” (Public Administration 1996).

## **The Advantages and Failures of the Civic Sector**

### *Defining the civic sector*<sup>8</sup>

The civic sector is spawned by civil society, which draws on the public’s civic responsibility for its existence. Etzioni characterizes citizenship as a moral responsibility of the individual to the society in which he lives.<sup>9</sup> This responsibility prompts individuals to do something for others.

*“... if (the concept of citizenship) is introduced in the home, cultivated in schools, promoted in the media, propagated by volunteer associations, and heard in the speeches of presidents and other civic leaders, a nation feels bound to contribute to the prosperity of its society” (Etzioni, 1988).*

Civil society may then be understood as

*“... an independent, self-organized society whose individual parts voluntarily involve themselves in public affairs in order to satisfy individual,*

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<sup>8</sup> Besides the term civic sector, there are other expressions used more or less as synonyms, for example, non-commercial sector, non-governmental sector, civic associations and initiatives. Authors wanting to highlight the civic sector’s position within the confines of the market and government, choose the term third sector (Streeten, 1993: 1288). The term civic sector will continue to be used in our text (Brown, 1994), meaning the entire set of institutions enabling citizens led by motives other than profit to associate, including the conditions and resources which are created for them. The individual institutions in this sector are called non-governmental organizations (NGOs) or non-profit organizations (NPOs).

<sup>9</sup> This definition of citizenship differs from its technical meaning (having legal status as citizen of a given state).

*group, or public interests in the framework of a legally defined relationship between the state and society” (Weigle – Butterfield, 1993).*

Civil society operates through constantly creating, fulfilling, and dissolving social relations between citizens. It enables citizens to collectively express and act upon their opinions and values. Civil society encompasses two basic components:

- a legal framework defining the conditions of the relationship between government and self-governing institutions
- social actors characterized by their civic attitudes towards public concerns, as previously defined by citizenship.

It is necessary to understand that situations may arise when a society has the potential for citizenship, but the government does not create the necessary institutional framework for its cultivation and utilization. Citizens are, therefore, left with no choice but to find alternative (even illegal) means of association in order to realize this potential, as was true under the Communist rule

The **civic sector** is the institutional manifestation of the existence of civil society. It is formed by non-profit organizations, which are a form of volunteer association of citizens who share common values and a willingness to cooperate on a common purpose. The following table characterizes the peculiar positioning of the civic sector between the public and private sectors.

**Table 4-3:**  
The domain of the civic sector

<i>Allocation mechanism</i> ⇔ <i>Criteria of activity</i> ↓	Public budgets	The market
Public interest	Government	<b>Civic sector</b>
Profit	-----	Commercial sector

While the public sector depends on political processes and employs legislation and public budgets, the commercial sector uses the market to optimize decisions about production and the exchange of goods. The civic sector, on the other hand, needs reliable information about human needs if it is to satisfy them in areas where they aren’t being adequately satisfied by either the commercial sector or government. The civic sector is independent of the government; in this sense, it behaves as the private sector. Its activities aren’t motivated by profit but by the desire to satisfy the interests of a specific community; in this sense, it behaves as the public sector. For this reason, a number of authors recommend that the civic sector be referred to as a specific third sector, in which non-profit organizations

abide by rules that are distinct from the laws of the market and the functioning of the state and its institutions.

Analysts of civic sector development call attention to the fact that non-governmental organizations tend to operate where neither the market nor the government are effective. Therefore, is it possible to conceive the *raison d'être* of NGOs as a sort of *bypass* of the market and/or government? This is probably true, however, such a definition doesn't fully features their role. In the long run, NGOs cannot replace the market or government in their primary functions. In many cases, however, they are able to complement them.

Conditions which govern the functioning of the civic sector may significantly support and cultivate or, alternately, mute and destroy the potential of social participation: people's willingness to be involved in formulating social circumstances for the life of the entire society. A more specific distinguishing characteristic is whether a given NGO is engaged in meeting the needs and interests of its own members, or if its activities are oriented towards assisting others by promoting and fulfilling public interests. Naturally, one focus will be predominant over the other. It is difficult to find an organization, which focuses strictly on either public or group interest.

NGOs form an essential institutional framework, which enables citizens to associate and influence public affairs in the role of partners of government and market institutions. Nevertheless, if citizens lack the interest to participate, implementing adequate legislation and economic conditions for NGO activity will not guarantee the development of the civic sector.

Considering the irreplaceable role of the civic sector in the transformation of post-communist countries, a special chapter is dedicated to it (see chapter 7 *The Role of the Nonprofit Sector in Public Policy*). At this point, we will only concentrate on the analysis of the regulative functions of this sector in relation to the market and government.

#### *Advantages of the civic sector*

The civic sector is more effective than the market and government in activities that:

- generate minimal or no profit
- require compassion for the needs of others and a willingness to help them
- require a holistic approach
- provide immediate and sensitive assistance to individuals (day-care, consultancy, assistance to the ill or handicapped)
- assume considerable trust on the part of clients
- require volunteer involvement
- gain financial support through grants
- encompass moral criteria and individual responsibility in the chosen activity.

McKnight (cited in Osborne – Gaebler, 1993: 66) presents the following differences between services provided by professionals, on one hand, and those provided by civic associations on the other:

- associations have more commitment to their members than service delivery systems have to their clients
- associations understand clients' problems better than service professionals
- professionals and bureaucracies deliver services; associations solve problems
- institutions and professionals provide "service"; associations provide "care"
- associations are more flexible and creative than large service bureaucracies
- associations are less expensive than service professionals
- associations enforce standards of care they provide more effectively than bureaucracies or service professionals
- associations concentrate on stimulating their clients' dispositions to solve problems; systems of services for providing services that replace the client's own motivation.

In the language of economics, the civic sector is best involved where comparative transaction costs of regulation and execution of the activity would be unreasonably high if the market or government were to intervene.

NGOs, which support public initiative and entrepreneurialship, while searching for ways of covering their own costs, combine the successful characteristics of government institutions with those of a private firm. In this way, they may avoid the failures of both and, therefore, be the most effective institutional alternative. We write "may" consciously, because there is no guarantee that they won't combine the typical drawbacks of government on the one hand, and the market on the other.

### *Failures of the civic sector*

The failures of the civic sector are less familiar than those of government. Nevertheless, several characteristic situations where non-profit organizations typically fail have been identified.

*Insufficient capacity for dealing with extensive tasks.* The informal aspect of the civic sector, which is advantageous in many specific situations, can transform into a disadvantage when it becomes necessary to exert significant and extensive effort from a large number of people. A disciplined and professional public administration, or the strong motive of profit, can be at an advantage in these situations. This failure is, however, more common in smaller, informal organizations while traditional, well-organized non-profit organizations that are less dependent on volunteer work (schools, hospitals, etc.) can successfully avoid such failures.

*The absence of civic initiatives where they are necessary.* The attraction of the civic sector rests in the involvement of citizens in matters that they themselves consider important. Sometimes, however, their interest differs from that of the general

public. If government is too dependent on cooperation with the civic sector, then it could happen that it won't find a suitable partner.

*Heightened sensitivity to the personal characteristics of participants.* Mutual trust is the cement that connects citizens who take part in the work of civil associations or initiatives. Therefore, interior conflict can be devastating for such organizations. The personalities of the leaders of these organizations pose an especially large threat. They may tend to usurp too much power in their own hands or manipulate the organizations to their own ends – namely in places where control mechanisms are weak or completely missing. NGOs aren't immune to the danger of oligarchy.

*Threat of bureaucracy to the activities of NGOs.* The means – implementing the programs of NGOs through administration – can be transformed into an end in itself.

*Insecurity and instability of the civic sector.* Although some NGOs show significant long-term results, in many cases they are fragile institutions with no guarantee that they will survive and responsibly satisfy a significant segment of the public's interests and/or the needs of their clients.

*A screen concealing the profit motive.* Where NGOs operate in a legal vacuum, i. e. the legal framework for their activities is insufficient or fails to monitor their economic ventures, room for abuse is created. Public good can become a mere front, behind which NGOs hide their illegal profit (for example, tax evasion, paying unreasonably high honoraria), which is comparable to profit from legitimate business activities.

## **Conclusion**

Until now, we have analyzed the market, government, and civic sector individually. We will now attempt to indicate a relationship between the functioning of these sectors. Each characterization of these relationships will limp along somewhat because there have been many contradictory theories, a number of mutually contradictory explanations, and institutional tensions. The only aspect of this issue, which has general validity, is the maxim – stay with the facts, don't succumb to cheap simplifications that are attractive only in their simplicity.

### *Changes in the relationship between the market and the government*

The past and present offer a number of examples of fluctuation in the relationship between the market, government, and civic sector. Slavery was a very desirable institution from an economic perspective: it pushed the costs of labor down to a minimum. The flipside was the miserable living conditions of slaves. Inequality reigned between them and free citizens and weakened the basic sentiment for justice. The recognition of universal human rights by the state resulted in the abolition of slavery, which had an immediate impact on the prevailing conditions on the job market. Increased labor costs understandably handicapped firms previously profiting from slave labor.

Looking at the industrial evolution of developed countries in the last 100 to 150 years, it is surprising how significantly the role of the state in people's lives has increased in comparison to that of the market.

*"The prevailing tendency of development has been to expand public projects. Many unspecified projects gradually gained the characteristic of projects belonging to a specific society or nation, which could not be realized on the market by private persons" (Hendrych, 1992: 14).*

The public consumption as a share of the Gross Domestic Product of developed countries was continually increasing through the 20th century and currently varies between 30 and 50 percent. Although efforts are being made to explain this development exclusively as the result of subjective political will, it is primarily an objective evolutionary process resulting from the increased complexity of society. The need to provide people with various (public, merit, mixed) goods cannot be left to the free play of the market forces. The processes of industrialization and urbanization have gradually forced the government to organize, finance, and in some circumstances run programs in areas in which the state has not been active at all in the past.

Lindblom considers the possibility of fundamental changes in the role of the market and the state in ensuring greater equality of income distribution among individuals. The hypothetical free market would undoubtedly exacerbate inequality in incomes from salaries, rents, interest, and profit, because each individual could only depend on what he could offer for exchange on the market. However, the effects of the modern market are modified by taxes, public expenditures, and other regulating mechanisms. One can easily imagine a functioning market with a more equal distribution of wealth than what we are used to today. Even the majority of inhabitants both in Western and "new" democracies believes that differences between rich and poor generated within and among contemporary capitalist societies are too high. Some argue that when differences in income are decreased, the motivation for productive work is lost. As a rule, the opposite is true: if it is more difficult to earn additional income, people will work harder. How an individual will truly act, depends on his subjective decision between work and free time, which in turn depends on culture, personality, and many other variables of social and labour organization which either support or mute the motivation to work. The barrier to greater equality of incomes and wealth is not a product of the inner logic of the market. It is a historically inherited and politically maintained inequality of individually held possessions, positions, salary levels, and shares in income. In principle, the government may redistribute income and wealth and repeatedly re-distribute so often as it wishes. The fact that it doesn't tend to act that way needs to be explained politically rather than by looking to the "nature" of market itself.

*The market and the government – an uneasy alliance*

Lindblom shows that in various social arrangements, politics and economics depend on each other.

**Table 4-4:**  
Types of politico-economic systems

Political system ⇔ Economic system ↓	Democratic	Authoritarian
market oriented	democratic capitalism	market oriented, but without guaranteed human and civil rights
centrally planned	—	socialist countries

Source: Lindblom 1977: 161; modified

A noteworthy discovery! While market societies may or may not be governed democratically, democracies cannot exist without a market. Countries (in fact the majority of countries in the world) that have a market, but in which democratic government and a fully functioning civic sector are still unfamiliar, illustrate that the market isn't an automatic guarantor of democracy:

*“Market economics can coexist with one-party rule. Although reforms leading to the implementation of a market economy may safeguard the existence of specific groups and individual interests, they do not necessarily lead to democracy” (Batt, 1991: 33).*

Do any general reasons for maintaining the role of the government in market regulation exist? Ernst Gellner (cited in Musil, 1996: 31) comments:

*“Side-effects of unlimited economic activity would destroy everything – the environment, cultural heritage, and human relations. These powers simply must be politically restricted even though the control should be gentle, camouflaged, and negotiated. The economy must be strong enough to create plural institutions, but not strong enough to destroy our world.”*

In democratic, market oriented societies, the regulatory role of government isn't at all simple. The government in many ways depends on the private sector. Because public business functions (maintaining employment, prices, production, growth, standard of living, and the economic insurance of individuals) are often performed by private businessmen, the government tends to be indifferent to the methods with which these businessmen achieve their goals. Therefore, business-



men in general, and corporate management in particular, have very high standing in relation to government; a standing which is incomparable to any other group except maybe of civil servants themselves. The risk of government failure grows, as decision makers find themselves bound by interest groups with specific agendas (Mlčoch, 1997).

This contemporary dualism of governing is reminiscent of the medieval dualism between church and state. The relationship between government and business is no less complicated. Mutual compatibility between the government and business can be found in the following areas:

- the state oversees and regulates entrepreneurial activities
- this regulation is limited by the threat of negative consequences of its implementation which can affect the public functions of business
- the state is also limited in other areas of public policy with regard to the possible negative impact of government regulation on the business sector
- the representatives of business circles actively promote their personal interests in negotiation with government representatives, even resorting to the threat of decreased economic activity if their demands aren't met
- businessmen hold a privileged position, being both passive participants, as well as having an influence over governmental decisions
- the state has the hypothetical authority to deny the commercial sector some privileges or even to liquidate a firm or entire business sector.

A noteworthy symbiosis occurs between government and business, in which neither side has an interest in manipulating the basis of the relationship. Although businessmen won't have all their interests met, they will succeed in most.

The functioning of the market won't work without competition. Competition is, however, a form of conflict. No other institution besides the government can create specific control mechanisms for keeping this conflict within certain bounds. If the state fails in this function, this otherwise productive and constructive conflict may escalate to the point of destroying those social ties, which are a condition of market exchange (for example, trust between the participants of the exchange) (Etzioni, 1988). Post-communist countries offer many examples of this danger.

### *The government and the civic sector*

In principle, the government may take three stances toward the civic sector:

- hinder its creation, eliminate it if it already exists, or make it subordinate
- take no interest in it whatsoever
- stimulate its development and functioning.

The first stance is typical for totalitarian regimes, which attempt to limit the sphere of independent civic life. NGOs are the institutional essence of this independence. The third stance is dominant in those countries (such as the Netherlands),

which have no problems with the existence of self-conscious and independent citizenship, and where NGOs have already found their niche.

Legislation governing the creation and activities of NGOs varies in different countries. If the originality of this type of institution is taken into consideration, the legislation can be beneficial. Besides direct financial support drawn from the public budget, the state helps NGOs through tax-breaks applied either directly to the organizations themselves, or to their sponsors in the commercial sector.

Historical context plays a large role in the attitudes of individual states. Europe, with a hundred-year tradition of strong, centralized states is less inclined towards the civic sector than the United States, with a weaker government and a long history of civic cooperation and philanthropy. In Europe, however, states take a much larger role in financing the civic sector than in the USA, where a stronger tradition of support from private sources exists.

The preparedness of the population to carry a portion of public problems on their shoulders through civic sector activity is also important. By doing so, they lighten some of the burden of government and decrease the pressure on the total tax burden. In this way, civic activism “pays off” for the citizens of a given country. The inverse is also true: civic “laziness” decreases the disposable income of citizens, because the state must take on more responsibility in public matters. This is not only more costly, but also not as effective and goal oriented.

### *The market and the civic sector*

In the relationship between the commercial and civic sector, we find less friction and resentment than if we analyze the relationship of both of these sectors to the government. This is because they are to a certain degree dependent on legislation and other conditions created by the state; firms and NGOs are pushed forward by individual and group initiatives and, in this sense, feel similar restrictions and solve similar problems.

The institution of sponsorship is significant. The commercial sector may, through voluntary contributions, support the activities of the civic sector and, through its choice of recipients of its grants, can take part in deciding which activities will have priority. At the same time, the commercial sector can utilize the fact that it provides this support for its public relations purposes.

When the activities of the civic sector are not suitably regulated by law, and when moral norms are weakened, misuse of this institutional form may be the result. Commercial activity is seen as generally beneficial and NGOs become a mere cloak for tax evasion and other forms of illegal enrichment.

### *The simultaneous use of the market, government, and civic sector*

As is evident from the presented overview of regulators and the relationships between them, their interactions are not without problems. Nevertheless, the available evidence allows us to summarize that:

- each sector has its benefits and drawbacks
- each sector has specific domains of effective activity
- the effectiveness of each sector depends on the extent to which their activities are tuned to each other.

Let us now compare the basic characteristics, pluses, and minuses of regulation, which are typical for each sector. This will allow us to think about the manner in which each sector can complement, support, or on the contrary, weaken or interfere with the others.(see tables 4 – 5, 4 –6 and 4 –7

**Table 4-5**  
Basic characteristics of the public, commercial, and civic sectors

<b>Characteristics</b>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic sector</b>
basic functioning mechanism	government	market exchange	voluntary association
decision makers	administrators, experts, citizens	individual producers, consumers and investors	leaders and members of organizations
regulator of activity	statutes	price signals and modification of amount	agreements
decision criteria	political objectives-and the best means of their realization	efficiency-maximizing profit and/or benefit	members interests/public interests
sanctions	state authority with the threat of enforcement	financial loss	social pressure
direction of operation	from the top, down	horizontal contracts	from the bottom, up

*Source: Uphoff, 1993 – modified*

**Table 4-6**  
The qualities of various sectors in providing given services

<b>Criteria:</b>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic Sector</b>
<b>Public Sector Strengths</b>			
Stability	good	poor	average
Ability to handle issues outside of the central mission	good	poor	average
Immunity to favoritism	good	average	poor
<b>Commercial Sector Strengths</b>			
Ability to quickly react to changing circumstances	poor	good	average
Ability to innovate	average	good	average
Tendency to replicate success	poor	good	average
Tendency to abandon the obsolete or failed activities	poor	good	average
Willingness to take risks	poor	good	average
Ability to generate capital	average	good	poor
Professional approach	average	good	average
Ability to take advantage of the economy of scale	average	good	average
<b>Civic Sector Strengths</b>			
Ability to reach diverse populations	poor	average	good
Compassion and commitment	average	poor	good
Holistic approach to problem solving	poor	poor	good
Ability to invoke trust	average	poor	good

*Source: Osborne – Gaebler, 1993: 347 – modified*

*How to optimize the regulation by the market, government, and civic sector*

In the previous years, there has been a growing consensus between experts of various fields, that the market, government and civic sector play an irreplaceable role in regulating the activities of social actors. It is also necessary to become more familiar with the methods, which would optimize the sectors’ effectiveness in the resolution of imminent problems in communities, states, and sub-national societies, and lead to a maturation of their “new partnership”. (Brown 1994) These authors are able to draw from the experiences of the past which clearly illustrate that one-sidedness can be deceiving and, at the same time, how human thought and

**Table 4-7**  
Tasks best suited to each sector

<i>Functions:</i>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic Sector</b>
<b>Best suited to Public Sector:</b>			
General regulation	suitable	unsuitable	depends on context
Policy management	suitable	unsuitable	depends on context
Guarantee of equity	suitable	unsuitable	suitable
Prevention of discrimination	suitable	depends on context	depends on context
Prevention of exploitation	suitable	unsuitable	suitable
Promotion of social cohesion	suitable	unsuitable	suitable
<b>Best suited to Commercial Sector:</b>			
Economic tasks	unsuitable	suitable	depends on context
Investment tasks	unsuitable	suitable	depends on context
Profit generation	unsuitable	suitable	unsuitable
Promotion of self sufficiency	unsuitable	suitable	depends on context
<b>Best suited to Civic Sector:</b>			
Social assistance	depends on context	unsuitable	suitable
Tasks that require volunteer engagement	depends on context	unsuitable	suitable
Tasks that generate little profit	depends on context	unsuitable	suitable
Promotion of individual responsibility	unsuitable	depends on context	suitable
Participating in the life of the society	depends on context	unsuitable	suitable

Source: Osborne – Gaebler, 1993: 348 – modified

activity can be easily lured onto a path that deviates from the fragile equilibrium between the regulators:

- **Socialism** leads many of its champions from a belief in the meaning of collective happiness to overestimating the role of the government as a guarantor of social justice – with familiar negative impact on human liberty.
- **Neoliberalism (libertarianism)** is a school of thought, which overwhelmingly prefers the market as the sole regulator. In this way it threatens the basic premise of modern, stable societies, i. e. creating and sharing common values, and preserving social cohesion and order.

- **Anarchism**, with its disdain of state institutions and the market, would prefer to see society organized on the basis of pure spontaneity and volunteerism. What institution could be more suitable for this view of society than the civic sector? The problem remains, however, that its existence is dependent on both a functioning market and state.

Historical development isn't usually linear, even if it is partly influenced by the implementation of the previously mentioned one-sided doctrines; it brings fundamental reversals in proportions and reciprocal relations in the implementation of the market, government and civic sector. However, history always leads one-sided solutions (and their protagonists) to their proper limits, albeit for the price of significant destructions and lost opportunities and after decades of confusion. It can be said that an ideal and universally applicable model of relationships between the different sectors does not exist – and cannot exist.

Uphoff (1993) is one of the authors that is firmly convinced that it is possible to achieve a **positive synergy between the functioning of the market, the government and the civic sector**. In order to transform this hypothesis into a convincing theory, it is necessary to systematically increase our knowledge of how to most effectively apply these alternative, although complementary and co-dependent regulative tools. It is especially important to pay attention to the cultural milieu, legislative and institutional environment, and quality of human resources, all in the context of global evolutionary trends, threats, and development opportunities.

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# Chapter 5



# **Public Policy Institutions: The State and Bureaucracy**

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## **Introduction**

Public policy institutions pervade people's day-to-day lives. These institutions regulate and control their lives in the working place and in the neighborhood. Indeed, public agencies have a profound impact on our lives from the moment of birth to the instant of death, in our childhood through our old age. The intervention of public policy institutions has had an increasingly positive and directive character in the 20th century. The scope of their intervention has broadened and nowadays encompasses areas of economic activities that have traditionally been considered private. Today, public policy institutions make policies in a great variety of areas including education, health, labor, welfare, transportation, defense, economy, and many others.

There are many actors in the public policy process including legislatures, political parties, governments, lobbyists, interest articulation groups, trade unions, churches, and other integrative organizations. In addition to the regular actors, we can find occasional actors as well. For example, the Constitutional Court becomes part of the public policy process when it determines whether a proposed act in the parliament is unconstitutional. Other casual participants include temporary or goal-oriented organizations, spontaneously formed pressure groups, and the like. Among these different actors, the most decisive and substantial are the public policy institutions.

This chapter looks at two crucial elements of public policy – the state itself and state bureaucracy. We will consider state institutions, including theories of the role of the state. Turning to the bureaucracy, this chapter examines the development of modern bureaucracy, theories of bureaucracy, and the characteristics of bureaucracy. In the conclusion, we consider the disadvantages and problems with bureaucracy. This chapter is paired with the subsequent chapter, where we continue this theme by considering the development of the field of public administration and how it has analyzed the state and bureaucracy. It also examines new responses such as New Public Management and how new concerns include efficiency and accountability.

## **Public Policy Institutions and the Functions of the State**

Public policy institutions exercise crucial influence on organized political power in contemporary society. The state has different institutions including legislative bodies, (parliamentary assemblies and subordinate law-making institutions), executive bodies, and judicial bodies. There are differences among the political systems as to whether legislative, executive and judicial institutions are separate from one another or overlap. In Western Europe, there is a considerable overlap in parlia-

mentary institutions, while in the United States in contrast the three branches of the state consist of distinctive institutions.

There are three levels of state institutions: national, regional, and local. The degree of autonomy at the regional and local levels is crucial because of its influence on the implementation process. In the democratic political system, local institutions have significant autonomy and therefore, are subject to different political influences. Interest groups have real opportunities to influence political decisions and can cause major modifications in decisions concerning policy implementation.

Traditionally, the state performs certain fundamental functions. Among the more important of these is the maintenance of law, order, and peace – in other words, the maintenance of internal and external security. All political systems employ police and armed forces to guarantee internal and external security. The state also has an important role in protecting property rights and in establishing a system for dispensing justice among citizens.

During the twentieth century, the role of the state has expanded. In addition, to the states' traditional, control, regulative and judicial activities, the provision of services and the operation of the economy have become major functions. The areas of state intervention are of particular importance. The first of these areas is the welfare function, which includes the provision of such services as education, public health, pensions, income maintenance, and housing. The second area is intervention in the operation of the economy by facilitating industrial development through subsidies and tax concessions, by direct involvement in the productive process, and by monetary and fiscal policies aimed at regulating the economy. The third area includes regulatory activities to limit the adverse impact of individual behavior by, for example, environmental protection, consumer protection, and the limitation of the exploitative potential of monopolies and cartels.

In the 1990's, Central and Eastern Europe took leave of the old order. Long existing structures and mechanisms collapsed. Totally new forms of public policy institutions have already been created to replace them. The new democratic political systems are faced with the task of organizing changes in three dimensions:

- from totalitarianism to democracy
- from command economies to market economies
- from a bloc structure to national independence

Historically, there are two types of systematic transition to the market economy. The first is the market-led, evolutionary type – we can call it the “organic” type. This was the road followed by Great Britain, the first industrial nation, and later by the United States, France, the Netherlands, Belgium, and the Scandinavian countries. In this type of transition, the state did not have a dominant role, rather it merely facilitated the development. The second type is a functional one, state-led transitions, in which the role of the state was decisive, especially in the beginning. In this type of transition, the state assisted the private sector in many ways. It created the overall legal and economic framework for the transition and also

served as a major economic agent. However, even though the role of the state in functional transitions is critical, the state does not usurp the place of the private economy. The performance and the commitment of the society to the transition were decisive in the long run.

The current period of transition in Central and Eastern Europe is clearly not of the organic type. Although this type of transition is attractive, the conditions necessary for it do not exist in Central and Eastern Europe. Countries in Central and Eastern Europe started from a more unfavorable base. Moreover, there are serious political pressures because of the demonstrative impact of living standards in the Western world from outside and the illusions and expectations of the population inside. Thus, the people of Central and Eastern Europe are not willing to wait for the lengthy period of time required by an organic transition. That is why these countries are forced to follow the functional pattern of transition.

Therefore, there are a great variety of tasks that have to be undertaken by the state in Central and Eastern Europe:

- In fiscal and monetary policy, the state must control the money supply and assume responsibility for the government's budget.
- The state must develop the necessary infrastructure (railways, telegraphs, steel, electricity etc.) and establish housing programs and model factories.
- The state must provide extensive aid and encouragement to the private sector through tax concessions and allowances; low interest loans, grants, and subsidies; and by promoting competition and eliminating restrictive practices, developing strategies for industrial development, stimulating the import of foreign technology, and helping to restructure declining industries.
- The state must develop policies for immigration, policies for labor supply, policies for worker participation, legislation for determining the rights of trade unions, welfare policies, education and training policies, policies for promoting research and development, and policies for improving standards in sciences and technology.

Given these responsibilities, it is evident that the transition from command economy to market economy and from totalitarian state to pluralist, multiparty democracy requires essential reforms in the basic functions and institutions of the state.

The new state must provide the legal framework for the economic development instead of directly organizing the economy, as was the case prior to the transition. Instead of the cultural-educative function, the state has to function in cultural life and in education without ideological priorities. Instead of being an integrative factor, the state must promote restoration of civil society.

The most important elements of public sector reform include:

- Privatization programs through the contracting out process
- Decentralization of decision-making to the regional and local level, providing genuine legal and financial autonomy for local institutions

- deregulation reforms that make the long, complicated laws and regulations understandable to the public
- transforming and flattening organizations so that they are not only relative, but also proactive in connection with changes in public requirements and remands
- changing procurement policy, financial, human resource management, and information systems in public organizations so that government agencies can work more effectively to develop new forms of cooperation with the non-governmental organizations and the private sector and give more attention to the citizens they serve
- measuring the performance and the outcomes of public sector activities by reviewing and monitoring, rather than by commanding and controlling.

It is obvious that all organizations in the public sector have to adjust and accommodate to the changing circumstances. These changes are rapid and in many cases they are unpredictable. Therefore, public organizations need to be stable and able to keep up with the changes.

### **Theories on the Role of the State**

There are four major theories concerning the role of the state: pluralism, elitism, Marxism, and corporatism.

#### *Pluralism*

Pluralism emphasizes the constraints and pressures exerted by a wide range of groups in society. According to this theory, public policy is essentially a reflection of the preferences of these groups. Classical liberal theory (John Stuart Mill, Jean-Jacques Rousseau) which is consistent with one variant of pluralism, emphasizes the need for direct and active involvement of the citizens of a nation in the running of its government. More recent exponents of pluralism – for instance Schumpeter – stressed the central role of regular competitive elections. According to their ideas, public policy is an “institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people’s vote”. (Schumpeter, 1974. P. 269.)

In the most recent interpretations of pluralism, the role of political pressure groups has become more decisive than the role of regular, open elections. Richardson and Jordan explained that the welfare state has already reached the stage of “post-parliamentary democracy” (Richardson – Jordan, 1987) and on that level different public policies are developed through negotiation between government agencies and pressure groups, which are organized into policy communities. The foremost exponent of the American version of pluralist theory is Robert Dahl. According to what he calls “polyarchic” theory, power is widely distributed among different groups in politics. No group is without power and no group is dominant. However, all groups do not have the same degree of influence. It is because of the pluralist

presumption that the sources of power (money, information, and expertise) are distributed non-cumulatively and no one source is dominant. (Dahl, 1975)

“Public choice” theories emerged within the framework of concepts suggested by pluralism. The core part of these theories is that politics is similar to a marketplace in which parties compete to win power by responding to the demands of pressure groups (Tullock, 1976.) In this approach the elements of economic theory are applied to analyze political behavior (for example, see Downs, 1967).

The theory of “government business cycle” – which was evolved in close association with the public choice theories – contains two core components. According to this theory, government expenditures regularly increase before the general election in order to satisfy the demands of voters and reduce unemployment. As a result inflation and government budgetary deficits are a regular feature of the post – election period (Nordhaus, 1975).

### *Elitism*

Elitist theory emphasizes that public policy is dominated by a small number of well-organized societal interests. According to Pareto and to Mosca, the distribution of power is cumulative and power is concentrated in the hands of a minority group. In the classical form of elitism, the power of the political elites was based on military conquest, the control of waterpower, or the command of economic resources. In the modern welfare state, there are different kinds of elites and their influence is based on their position in public agencies and organizations. A distinction is made between the political elite and the political class. The political elite consists of “those individuals who actually exercise power in a society at any given time”. . . [including] members of the government and of the high administration, military leaders, and, in some cases, politically influential families of an aristocracy or royal house and leaders of powerful economic enterprises. On the other side, political class consist of leaders of political parties in opposition, trade union leaders, businessmen and politically active intellectuals. (Bottomore, 1996. pp. 14 – 15).

In the American version of elitism, C. Wright Mills pointed out that institutional position is a source of power, and therefore the distribution of power is not pluralistic (C. Wright Mills, 1956). This conclusion was supported in the United States by studies of local politics. The most famous among them is Hunter’s study of Atlanta, Georgia in which he pointed out that there is an elite behind the local power consisting of businessmen, bankers and industrialist.

### *Marxism*

The main focus of Marxism is on the influence of economic interests on political action. According to Miliband, the state is not a neutral agent. It is an instrument for class domination and the capitalist state’s main function is to assist the process of capital accumulation. (Miliband, 1969). The main opponent of Miliband is Poulantzas (1973) who argues that the class background of state officials is not as

important as Miliband suggests because there are structural constraints placed on the state by the objective power of capital. Both Miliband and Poulantzas believe that the state has relative autonomy.

### *Corporatism*

Corporatist theories deal with the impact of economic changes in industrial societies. According to these theories, corporate involvement by the state extends to policies on prices and incomes and planning agreements with industry. In this theory, social classes or groups do not control the state. Instead, they play an independent and dominant role in its relationship with labor and capital. Moreover, unions and employers' organizations are closely incorporated into the governmental system. The most famous representative of corporatism, Schmitter characterizes the ideal type of corporatism as follows:

*“. . . a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, noncompetitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports” (Schmitter, 1974, pp. 93 – 4).*

Schmitter distinguishes between state and societal corporatism. State corporatism is authoritarian and anti-liberal (for example, the political system of Fascist Italy). Societal corporatism in contrast, exists in pluralist political systems. It is alternative to pluralism yet it is a means for interaction between state and societal organizations and for interest representation.

### **Bureaucracy and public policy institutions**

The increasing importance of bureaucracy is the consequence of the development of a complex economic and political system in modern societies. This trend was already evident by the end of the last century, and from then on a process of bureaucratization could be observed in the public policy.

The most influential theory that recognized these trends and tried to explain them was that of Max Weber. Weber's theory of bureaucracy was associated with his analysis of types of authority. According to him, the three basic authority types are: charismatic, traditional, and rational-legal. Charismatic authority is based on “devotion to the specific and exceptional sanctity, heroism or exemplary character of an individual person.” (Max Weber, p. 328. 1947.) The weakness of charismatic authority is in its instability, which results from the personal nature of the relationship between the leader and his followers. This instability makes the development of permanent institutions difficult. Traditional authority can be characterized as “an established belief is the sanctity of immemorial traditions and the legitimacy of the status of those exercising authority under them.” The weakness of the traditional



authority is in its static nature. Compared to charismatic or traditional authority, rational-legal authority is ideal because it is based on, “a belief in the legality of patterns of normative rules, and the right of those elevated to authority under such rules to issue commands.” (Max Weber, p. 329, 1947.) The development of rational-legal authority is connected to the evolution of modern industrialized society. It is generally recognized that this type of authority is superior to the other two types because it meets higher performance standards.

Contemporary politics, Weber claimed, was being shaped, first, by the emergence of modern bureaucracy – most especially the growing state apparatus, increasingly led by technically trained, professional career administrators. The second trend Weber saw, to some extent oblique to the first, was the rise of a new class of professional politicians, their influence based on no inherited social status, but rather on mass political parties claiming membership and the suffrage of millions of ordinary citizens. Looking back more almost a century later, we can see that Weber’s insights were remarkably prescient. Every society of any size needs bureaucracy. Not all social interaction can be managed by altruism, anarchy, or market.

The public sector has to provide public goods and services in response to citizens’ legitimate needs and problems. This normative imperative is one of the most commonly accepted foundations of the modern societies. The development of public sector can be seen as a process of bureaucratization. The employees of public sector government offices, and administrative agencies have an important role of public decision-making. They are bureaucrats. The term is now commonly applied to government officials and employees, a group which in an early social climate was referred to more kindly as ‘civil servant’.

Bureaucracy and bureaucrats prepare the information for decision-making by politicians and implement the decisions made by politicians (parliament, government). There is a general trend in the modern societies towards rational bureaucratic authority; without it society cannot cope with the complex administration characterizing modern society.

What are the main characteristic features of bureaucracy? Bureaucrats:

- act or work on legal basis, their role is regulated by law, and their offices are run by fixed rules;
- maintain a hierarchical pyramid of authority within the office;
- manage the modern office on the basis of written document, “in the files”; officers are specially trained and work full-time at their jobs.

### **Theories on the Role of Bureaucracy**

In the course of this century, bureaucracies have been becoming central actors in the governments of post-industrial societies. Policies are administrated and in many cases also controlled, by a variety of ministries, public agencies, bureaus and offices, and other governmental units.

The *pluralist* approach implies that this trend is a possible threat to democracy. First, Michels pointed out that the trend towards bureaucratization became the characteristic of democratic mass parties as well – as he called it, “the iron law of oligarchy”. (Roberto Michels, 1915). This led him to the conclusion that power is concentrated among the top level of bureaucrats and politicians. Thus, even politicians are bureaucrats, rather than servants of the people. This raises the issue of whether bureaucratic power can be controlled by democratic forces? According to Mosca, the answer is that pluralism must be sustained to protect democracy from bureaucrats.

This line of reasoning was also followed by public choice theorists who emphasize that public policy issues – especially distribution issues – in modern society are better settled by markets than by bureaucracies. According to their arguments, public bureaucracies tend to be monopoly providers of goods and services and, in the absence of market limitations, tend to over-supply commodities. This tendency is associated with efforts to enlarge their enterprises: “As a general rule, a bureaucrat will find that his possibilities for promotion increase, his power, influence and public respect improve, and even the physical conditions of his office improve, if the bureaucracy in which he works expands.” (Tullock, p. 29, 1976).

In the *Marxist* view, the crucial issue is the independence of the bureaucracy. Their main argument is that the neutrality of bureaucrats involves a commitment to the status quo. Therefore, a bureaucrat tends to be against innovation and occurs to support the existing process by capital accumulation. Under this approach, bureaucrats can be considered as a new social class.

C. Wright Mills discussed opportunities for democratic control. He observed the increasing role of bureaucracies and that in many cases they serve their own interests. He suggested that in the course of the development of bureaucracies, centralized decision-making becomes increasingly important. He pointed out that, “In the polarized world of our time, international as well as national means of history-making are being centralized. It is not thus clear that the scope and the chance for conscious human agency in history-making are just now uniquely available? Elites of power in charge of these means do now make history – to be sure under circumstances ‘not of their own choosing – ‘but compared to other men and other epochs these circumstances do not appear to be overwhelming.” (C. Wright Mills, p. 244, 1963). Therefore Mills calls upon intellectuals, scholars, and scientists to take political responsibility for controlling bureaucracies.

### **Characteristics of bureaucrats**

When we discuss the role of bureaucracy in modern societies it is important to know what kinds of people are in powerful roles and who is able to influence them. According to Lipset: “The justified concern with the dangers of oligarchic or bureaucratic domination has. . . led many persons to ignore the fact that it does make a difference to society which set of bureaucrats controls its destiny.” (Lipset, p. 271, 1950).

Top officials and lower level officials both regularly influence the content of political decisions and they often cause modifications in the implementation process as well. In the 1980s, Lipsky's theory on the role of street-level bureaucracy (that is, local level bureaucrats) became quite influential. According to Lipsky, bureaucrats from the local level reshape policies. He argues, "...that the decisions of street-level bureaucrats, the routines they establish, and the devices they invent to cope with uncertainties and work pressure, effectively become the public policies they carry out." (Lipsky, p. xii, 1980)

As a matter of fact bureaucracies are complex structures and they have a great variety of demands upon the individual bureaucrats. The public often views bureaucrats negatively, believing that they are rigid and slow and foster what we usually call "red tape". But the public has a positive view of bureaucrats as well, holding that they are independent frontiersman who are trapped, as a result of their own good will, within the bureaucratic organization. Another picture of bureaucrats, which is quite common, is that they are individuals whose life is dominated by the complex rules that must be followed. People often enter public employment with some commitment to service, but that commitment is weakened by the conditions they work under and the expectation of the public they serve. As Lipsky argues: "Yet the very nature of this work prevents them from coming close to the ideal conception of their jobs. Large classes or huge caseloads and inadequate resources combine with the uncertainties of method and the unpredictability of clients to defeat their aspirations as service workers." (Lipsky, p. xii, 1980)

### *Desirable Characteristics of Bureaucrats*

In Central and Eastern Europe, an essential component of public sector reform is to establish of new values, attitudes, and skills among public officials. A new type of civil servant is needed, one who can be paternalistic or protective when required, but who can also work as a partner and a manager when necessary. The ideal personal profile of such a civil servant includes the following characteristics:

- productive and efficient
- empathetic
- tolerant
- reliable
- responsible
- loyal (but not subservient)
- positive toward people and problems
- neutral toward political parties
- creative and resourceful
- constructively critical
- respectful
- helpful and courteous
- flexible
- cooperative

How many civil servants now work according of these standards? How many are motivated by these values? It seems obvious that the majority of the civil servants do not. In addition, the following are technical skills are needed for improvement in the performance of the public sector:

- thinking strategically
- taking initiative
- working under pressure
- accommodating risk
- managing resources and people
- effective delegation of tasks and responsibilities
- prioritization
- cross-cultural understanding
- ability to work with new technology
- communication skills
- speaking foreign languages

These attributes define the ideal type of civil servant. The conditions that must be met, if civil servants are to possess the values and technical skills listed above are that they have:

- work that civil servants can identify with
- appropriate working conditions
- the rational share of competence
- salary providing a decent standard of living
- social support (support in housing for example)
- career opportunities for advancement

On the group level:

- favorable psychological atmosphere of working groups in the organization
- leaders who exhibit a clear and cooperative style

On the organizational level:

- clearly-defined and accepted organizational goals
- operational cooperation among the divisions of the organization
- a well-operating, modern information system
- practical results

It is quite clear that there is a lack of market-supporting institutions and of people with market-place skills within the government. Therefore, the task is to build up a critical mass of technical, economic and managerial expertise in identifying needs, working out projects and providing appropriate technical assistance.

### **Rationale and Advantages of Bureaucratic Organizations**

Bureaucratic organizations will not be the ideal form of organization for all activities. However, for activities in which functional tasks need to be repetitively and routinely completed, bureaucracies have proven to be essential and ubiquitous. Through task specialization and expertise, assignment and reward based on com-

petence in fulfilling duties, and ease of monitoring task success, bureaucracies produce efficient results. This includes efficiency in terms of resources and timely completion of jobs. To the extent that quality is built into task assignments, rewards, and monitoring systems, bureaucracies should also produce high quality products or services.

The results of bureaucratic actions should also be highly standard and consistent across applications. Standard operating procedures define task sequences, methods, materials, and often quality and other checks on the product or service being provided. In theory this means a consistent and predictable result. When failure occurs, hierarchical arrangement and specific task assignment should lead to a high level of accountability.

Bureaucracies also accentuate and reward expertise and skill development, Although some would argue that such skill development results primarily from the narrowness of the tasks assigned and thus retards general skills needed by organizations, one cannot ignore the logic of Adam Smith's pinmaker or Frederik Taylor's metal cutter, or the accomplishments of specialists in many modern fields. Although there are clear disadvantages of bureaucracies for many creative and innovative activities, compared to systems where people are organized based on non-functional traits such gender, birthright, or even random assignment, bureaucracies may be seen as producing major advances in knowledge and skills.

Bureaucracies are often attacked as being depersonalized institutions where people take on organizational roles, and thus become faceless, replaceable "bureaucrats". However, the system does make clear what is expected of employees and in theory allows for equal opportunity to compete for jobs and rewards. It also rewards employees based on objective measures of accomplishments and not on patronage, familial connections, or other non-job related traits.

Finally, clients of bureaucracies can expect to be treated equally in accordance with standard operating procedures that are publicly known. They will also benefit from the efficiency and quality of the products and services produced for them. Thus bureaucratic systems are relatively efficient, predictable, stable and produce continuous results that are known and expected.

### **Bureaucratic Disadvantages and Flaws in Practice**

Bureaucratic theory has been the subject of debate and attack for decades. In addition, mountains of research have dissected how actual organizations operate, and this behavior often deviates from the theory. These attacks range from classic studies such as the Hawthorne studies in the 1920s, that illustrated how employees counter bureaucratic designs, to modern management theorists who promote flat organizational structures (Roethlisberger and Dickson, 1939; Osborne and Gaebler, 1922).

The failures and disadvantages of bureaucracy are reiterate redundantly in classrooms and scholarly (See Goodsell, 1983 for a summary). It seems obvious

that bureaucracies may be ill suited to many forms of human activity. For example, few would argue that creativity is spurred through bureaucracies. Music, literature, scientific insights, creation (non production) of personal computers, some inventions, and innovative military strategies are just a few examples where bureaucracies may not produce maximum results, and may even stifle creativity.

Also, many organizations may suffer from excess bureaucracy. Bureaucracy may create serious problems for organizations that rely on individual freedom, expression, or belief and commitment. University faculties, inner-city gangs, performing groups, sports teams, and religious orders may fall into these categories. It is interesting to note, however, that in each of these cases, at times, very bureaucratic organizations develop either within or around these groups.

The failures and inappropriate application of bureaucracies are the result of pathologies of bureaucratic organizations (Merton, 1940; Thompson, 1961; Crozier, 1964). These pathologies are important for our discussion in that they serve as warnings to emerging nations as they attempt to reform their public bureaucracies. The problem of creativity is a specific case of the general difficulty of bureaucracies in adapting to changes of many kinds. Skills, expertise, procedures and methods, formal rules and regulations all become entrenched in bureaucratic organizations. As the needs of the organization change – in terms of tasks, skills, and rule changes will inevitably lag due to personal intransigence, the power of established routines, and the time required in making formal adjustments. Thus other organizational types will clearly be more flexible than formal bureaucracies.

The personnel advantages of bureaucracies are also offset by a number of potential disadvantages. Specialists trying to enhance the importance and rewards accruing to their roles may behave in ways detrimental to the goals of the organization and they may be able to escape detection. They can use their knowledge, access to information, and ability to control reporting requirements to enhance their positions rather than accomplish the tasks assigned. If isolated enough, or having union status, they may also simply shirk in their responsibilities. All of these problems will be aggravated during periods of change.

Research studies also demonstrated quite convincingly that bureaucratic organizations have often responded to factors other than organizational design and procedure. And these actions were often in reaction to the confines of the bureaucratic system itself. Thus while roles may be assigned individually, individuals often reacted as members of a group. This could lead to resistance against standards, such as defenses against “rate busting” or perhaps development in a unit of an attitude where rules and regulations need not be followed in, for example, an effort to cut “red tape” and thus better serve clients.

Internal accountability may also not live up to theoretical advantages. It depends on monitoring and reporting. While this may be easier in bureaucracies than in other organizational forms where informal, collective actions are the norm, it still may be difficult. In many instances, adequate measures of “production” or quality

are lacking. In others, those producing the results control the necessary data. This can lead to selective use of data to avoid punishments and increase rewards.

Finally, while bureaucracies have advantages for clients, the disadvantages are often highly publicized and even become the source of great literature, such as Franz Kafka's *The Castle* (Kafka, 1998). Rather than emphasizing equal treatment or efficiency, some authors highlight depersonalized treatment by a bureaucratic elite that is able to protect the jobs of its members and thus care little about the quality or efficiency of the services it provides. These complaints are enhanced by the size of bureaucracies, the perceived excessive rulemaking (red tape), and often the forms and paperwork that provide for international accountability and reporting, but which are meaningless to clients.

In some ways bureaucracy has been an easy target of both scholarly and popular criticism. Although we share many of these concerns, we also note the absolute persistence of bureaucracies and bureaucratic behavior in the twentieth century. Despite legions of scholarly tracks and consultant advice to reduce bureaucracy, create flat hierarchies, and democratize internal organizational decision-making, the fact of the matter is that not much has happened in this century to reduce bureaucracy, and very probably, it has increased considerably.

Bureaucracies are not likely to produce the next Beethoven symphony. However, when a Wisconsin dairy farmer needs a new pump for the milking parlor (which is the bureaucratic replacement of the family dairy farm), she will undoubtedly get it from an organization (private or cooperative) that is bureaucratically organized, and it will be ordered, shipped, paid for, and installed in accordance with bureaucratic procedures and rules. Similarly, when the Hungarian Ministry of Finance and National Tax Office promotes procedures for filing and payment of newly created income taxes, they will promulgate formal rules, which will apply to similar categories of "clients", who will be audited by personnel specializing in audits and who will more or less follow set procedures. Thus bureaucracy remains of monumental importance not only for emerging democracies, but also for mature democratic nations and all public and private organizations. In the following chapter, we look at the development of public administration, and new developments such as New Public Management in order to address issues such as efficiency and accountability.

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# Chapter 6



# Public Administration and Public Management: Approaches and Reforms

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## Introduction and Overview

Given the importance of the state and bureaucracy in understanding public policy, scholarly attention to these subjects has existed for more than a century. This chapter continues the analysis begun in chapter five by considering public administration, the study of bureaucracy. We examine the development of the field, the important dichotomy of politics versus administration suggested by Woodrow Wilson, and also consider the Principles School. Next, we turn to new models in public administration, including the New Public Management. These new approaches have come in part because of concerns raised in chapter five – bureaucratic inefficiency and waste. The last part of this chapter looks at new calls for accountability and citizen participation.

The traditional model of *public administration* can be characterized as “an administration under the formal control of the political leadership, based on a strictly hierarchical model of bureaucracy, staffed by permanent, neutral and anonymous officials, motivated only by the public interest, serving any governmental party equally, and not contributing to policy but merely administering those policies decided by the politicians.” (Hughes, 1994. p. 23.) The consequences of the French and German administrative-legal development (and also the administrative institutional and cultural heritage of “enlightened” monarchies in Central Europe) lead to this concept, which is summarized in the works of Max Weber. This model and definition had been widely accepted and used from the nineteenth century until the early 1980s’ across the Western world, but mainly in Continental Europe. The essence of this model is that in the modern governmental systems professional bureaucrats execute the tasks of public administration while separated from the political mechanism as well as from the private sphere. Such administrative systems were emerging from the highly centralized bureaucracies that served the feudalistic and absolutistic monarchs in the Continental Europe at the time of rapid modernization after the end of eighteenth century. In Britain and the United States, the process started later on and from below: at the end of the last century the lack of a Weberian public administration became an obstacle to effective government. The task was to establish professional administration based on *merit* and a high level of morality.

Despite of the different historical development of British and the American public administration, the Weberian approach became mutual at the end of last century. The end of the *patronage* or *nepotism* in the European countries and the *spoils system* in the United States demanded governmental administration based on merit and political neutrality instead of political dependence and *clientelism*.

Max Weber gave the criteria for *modern bureaucracy*:

- impersonal authority structure,
- hierarchy of offices in a career system of specified sphere of competence,
- free selection based on achievements in accordance with specified rules,
- remuneration based on clear contracts,
- discipline and control in the conduct of office. (See: Lane, 1993. p. 49.)

The earlier, pre-modern models of administration were based on personal relationships: the loyalty to a feudal patron or monarch, to a leader or to a party and not to the system itself. That model may have been more responsive politically, but it was more evidently an arm of the political leadership or the dominant elite. It was also often arbitrary, therefore unjust to those unable or unwilling to serve the incumbents. The formal regulations removed arbitrariness so that the same decisions were more likely to be made in the same circumstances. This is not only more efficient but more accountable as well. Nevertheless, the formal model of administration is “applicable to both the private and public sector, but there is little doubt it was embraced more readily and for longer in public administration.” (Hughes, *Ibid.*, 32.)

According to Weber’s *ideal-type* analysis, we have to take into account the “real-world” of bureaucratic organization, which reflects significant cultural differences among societies.

*“In some national bureaucracies there are strong service ethics and high degrees of formalism and impersonality. Elsewhere, these characteristics are weak and bureaucratic encounters involve a good deal of personalization, pleading, and bargaining. Further, whereas the authority and legitimacy of a bureaucrat in Germany, France, or Austria may be strengthened by the high social status accorded to such functionaries, in other societies, such as the United States, the bureaucrat may be more or less object of derision.”* (Quoted by Rosenbloom, 1993. p. 144.)

The Weberian model of bureaucracy is very accurate regarding the CEE societies, which inherited well-developed Austro-Hungarian and German administrative traditions.

### **The Politics-Administration Dichotomy**

Woodrow Wilson added an important dimension to the Weberian model of the public administration. He argued in 1886:

*“Administration lies outside the proper sphere of politics. Administrative questions are not political questions. Although politics sets the tasks for administration, it should not be suffered to manipulate its offices. . . . Public administration is detailed and systematic execution of public law. Every particular application of general law is an act of administration. The assessment and raises taxes, for instance, the hanging of a criminal,*

*the transportation and delivery of mails, the equipment and recruiting of the army and navy, etc., are obviously act of administration; but the general laws which direct these things to be done are as obviously outside of and above administration. The broad plans of governmental action are not administrative; the detailed execution of such plans is administrative.” (Quoted by Rosenbloom, Ibid., p. 33.)*

Wilson believed that the strict separation of politics – where policy derives – from the administration – where policies are administered – could eliminate the arbitrariness and corruption in the administration. This separation may have wider effects. Stillman argues that the dichotomy between politics and administration:

*“justified the development of a distinct sphere for administrative development and discretion – often rather wide – free from the meddling and interference of politics. The dichotomy, which became an important instrument for Progressive reforms, allowed room for a new criterion for public action, based on the insertion of professionalization, expertise, and merit values into the active direction of governmental affairs.” (Stillman, 1991. p. 107.)*

Additionally the separation created the emergence of a self-conscious field of study, intellectually and institutionally differentiated from politics. In the framework of the dichotomy there are three main facets of political control over administration: (Hughes, Ibid., p. 34.)

- The administrators have clear responsibilities and accountability: they advise political leadership on the development, and review and implementation of policies; and they are personally accountable through the hierarchy to the government and the people.
- There is supposed to be a strict separation between matters of policy, which are formally the responsibility of politicians, and matters of administration, which are left to the public service.
- The administration is politically neutral and non-partisan in the party-political sense and able to serve equally any political leader.

In theory, the consequences of the separation seem to be simple. But in reality, the politics and the administration have never been completely or clearly separated. Responsibilities often were fused as the politicians performed administrative duties and the administrators took political actions. Still, realization of the dichotomy has been an objective of parliamentary democracies in their constitutional and governmental settings.

### **Golden Age of Public Administration**

While the modern (Weberian) public administration had been formed in Continental Europe earlier than in the United States (and Britain), American public admin-

istration did not simply follow it but exhibited a different way of development. Both stressed the necessity of an *impersonal, formally regulated and hierarchical* mechanisms. In public administration, an anonymous bureaucrat is setting up a “process” and dealing with a “case”, not with a person. It is not an accident that modern industrial organizations have the same principle: the worker has to adapt to the machine and technology. The transfer of effective management methods between the large private and public organizations was rather evident in America, which had developed and attained a strong business culture. “Although the theoretical foundation in bureaucracy and political control were firmly established and essentially unchanged, there were public sector adaptation of management theory.” (Hughes, *Ibid.*, p. 35.) Wilson emphasized that, “It is the object of administrative study to discover, first, what government can properly and successfully do, and, secondly, how it can do these proper things with the utmost possible efficiency and at least possible cost either of money or of energy.” (Wilson, 1941. p. 494) The importation of managerial innovations from the private sector characterized American public administration. The first and most important theory transferred from the private organizations was the *Scientific Management*.

Frederick Winslow Taylor published his fundamental work “Principles and Methods of Scientific Management” in 1911. His belief was that the ‘*one best way of working*’ might be revealed with scientific methods and standardizing the work helps to set up effective controlling mechanism for the maintenance of the standards. As Fry says (Fry, 1989. p. 60.):

*“Three components – time-and-motion studies, wage-incentive systems, and functional organization – constitute the core of Taylor’s scientific management. But Taylor would object to the notion that these, or any other listing, of procedures and techniques capture the essence of scientific management. For Taylor, scientific management is more than a ‘series of expedients to increase efficiency’. Instead scientific management requires a ‘mental revolution’ on the part of both management and workers as science replaces rule-of-thumb and mutual confidence replaces suspicious watchfulness.”*

The idea of ‘one best way’, the standardization of work, the systematic control, and the hierarchical organization fit public administration. In spite of some contested elements (time-and-motion studies, simplified personal motivation), scientific management was the most influential theory in the public sector until the 1940s’. As Stillman argues, “it all fits neatly together: a strong, effective administrative system could flourish if politics was restricted to its proper sphere, if scientific methods were applied, and if economy and efficiency were societal goals.” (Stillman, *Ibid.*, p. 110.)



## The Principles School

The “classical” approaches of Weber and Taylor have been referred to as the public administrative “orthodoxy”. Many followers and developers advertised the principles of this classical theory. In 1937, a series of ‘Papers on the Science of Administration’ was published in which the most important principles of orthodoxy were more or less codified. The editors were Luther Gulick and Lyndall Urwick, the outstanding representatives of management science.

According to Straussman, the principles school developed during the 1930’s, under the time of the New Deal. “It was believed, that administrative management lagged behind the expansion of government activity. If the essential ingredients of management could be discovered, public managers would be equipped to assist the economic recovery and, later, win the war.” (Straussman, 1990. p. 68.) Luther Gulick, who was called as ‘Dean of Public Administration’, started his career with Woodrow Wilson in the reform movement for a professional, neutral and rational public administration. He followed the line of Max Weber and Frederick Taylor in establishing general rules of thumb to guide public managers. Gulick thought that a certain kind of organization provides administrators with the means to manage effectively. He stated, that by the principle of *division of labor*, the tasks should be assigned to those technically trained to perform them. The principle of *coordination* means that specialized tasks should be put into meaningful overall objectives. He also identified rules of thumb to determine the *span of control* in a hierarchical organization: (Straussman, Ibid. p. 69.)

- The limitation placed on a manager in terms of the ability to absorb information.
- The number of subordinates that must report to the manager.
- The complexity or simplicity of tasks.
- The clarity or fuzziness of the tasks that must be performed.

Gulick also claimed that unity of command is essential for the line units at the organization. This makes clear the responsibility of managers in the organization. Without the unity of command, there is no efficient execution and supervision. He added that the notion that *authority* of management should be commensurate with responsibility. There is also concern for the *homogeneity of work*, meaning a combination of dissimilar activities within a governmental unit (ministry, agency) could destroy its efficiency and effectiveness.

*“Gulick carried his search for administrative principles further by recommending patterns of organizations geared to utilizing these specialties. In this category, he recommended that agencies be organized according to place, or where services are dispensed (e. g., section, region); purpose of service (e. g., police departments, agriculture departments); process, or the types of training necessary (e. g., accounting, planning); or clientele, or categories of people served (e. g., farmers, minorities). (Morrow, 1980. p. 59 – 60.)*

The most important and famous principle set out by Gulick is one of general guidance for the chief executive in an organization. This is the *POSDCORB* set of functions:

- Planning – goal-setting methods applied by executives as a means of preparing future courses of organizational actions,
- Organizing – arranging the organizational structure and processes in an appropriate manner essential to achieving the goals,
- Staffing – recruiting and hiring personnel to carry out the organizational work,
- Directing – supervising the actual processes of doing the assignments,
- Coordinating – integrating the various detailed elements of these tasks in cooperation with other units and people in government,
- Reporting – tracking and communicating the progress of the work within the organization,
- Budgeting – fiscal and financial activities necessary to economically support the completion of the programs, services or activities.

Gulick's POSDCORB was a popular manifestation of the one-best-way methodology by which a few simple directives were followed in all circumstances. This concept was widely respected in 30s' and 40s'. Generations of public and private managers learned and practice POSDCORB as a necessary tool for administrative success.

### *The Hawthorne Effect*

In the late 1920s, researchers conducted experiments according to scientific management principles at the Hawthorne Plant of Western Electric in Illinois. They wanted to study how the change of lighting conditions in the workshop would effect the productivity of employees. Two groups of workers were selected: an experimental group, which worked in better lighting condition and a control group, which worked under unaltered circumstances during the experiment. The finding was surprising: both groups improved the productivity. Elton Mayo, the leader of the experiment gave finally the explanation what was later called the *Hawthorne effect*. The workers in both groups had special motivation during the experiment. This psychological context had stronger influence in their performance than other motivating factors. This finding conformed with the later theory of Abraham Maslow on *the hierarchy of human needs*. (Maslow, 1954) By that he meant that the self-actualization as a human motivation is on higher level at this hierarchy than the material needs. Mayo had substantial impact on the management of the public sector. The private sector was more cautious in accepting the importance of the *human relations* in the organizations, but some elements of the Hawthorne lessons have built themselves into management thinking.

It has been understood, as Straussman argues, that the result of motivation is not only productivity: it is also employees' satisfaction. Satisfaction is a result of

the workers' successful efforts. Finally, both satisfaction and productivity are part of a 'feedback loop'.

### *Challenges to the Principles School*

The basis of scientific management was questioned after the World War II, theoretically and practically as well. The most powerful criticism came from Herbert Simon, the Nobel Prize winner in economics. He reminded that "human behavior in organizations is best described as 'intendedly rational'" (Simon, 1957, p. 196.) Incomplete knowledge and information threaten complete rationality. Decision-makers of organizations and the individuals do not generally know their precise preferences, nor all the consequences of an important decision. They do not know which actions suit their goals most fully. The Simon's concept of "bounded rationality" is very important aspect of human behavior and decision making in organizations. His famous conclusion is dramatic:

*"Most of the propositions that make up the body of administrative theory today share, unfortunately, proverbs. For almost every principle one can find an equally plausible and acceptable contradictory principle. Although the two principles pair will lead to exactly opposite organizational recommendations, there is nothing in the theory to indicate which is the proper one to apply."* (Simon, 1946.)

In spite of the devastating criticism, POSDCORB survived and it has had impact on the management thinking until the latest decades.

The Weberian classical administrative model had some advantages for most of its history. In the hierarchical system everyone knew his or her place and extent of authority. Accountability for the activities and actions of the organization was also clearly known at all levels.

*"The system was also reasonably efficient and effective in a narrow sense and was generally able to carry out instructions, especially when they were given clearly. It was also reasonably free from the temptations of diverting public funds for the personal use of the bureaucrat. When tasks were administrative and relatively simple, when environment was stable, the system worked and worked well."* (Hughes, *Ibid.*, p. 42.)

The traditional model of bureaucracy was ideal for control. It allowed for certainty and standardization, but it was usually slow and costly. But today, the traditional model with its theories and practices no longer is considered to be adequate for management of the public sector. As one critic noted:

*. "From the 1970s, the public services encountered increasing criticism in most developed countries. There were three main problems. First, the model of political control was inadequate and illogical. Secondly, the theory of bureaucracy is no longer universally seen as providing techni-*

*cal efficiency Weber thought it provided. Bureaucracy may also have other social problems associated with it, particularly a tendency to be undemocratic. Thirdly, there was criticism from the Right as part of the argument advanced against bureaucracy as an idea, it being something that took away freedom and was inefficient compared to the market. (Hughes, Ibid., p. 43.)*

### **Bureaucratic Waste and Inefficiency**

How do bureau managers and employees operate? It is useful as a *first approximation to view them as seeking to maximize the size of their bureau's budget*. Large budgets will enhance the opportunities and resources available at all levels. As the bureau expands, the power, prestige, salary and other benefits to bureau managers will generally increase. At the middle and lower levels of employment, a larger budget and bureau expansion will offer additional job security and possibilities for promotion. Large budgets are also likely to generate additional funds for office space, furniture, travel, and other resources, which improve the work environment of bureaucrats. Almost every bureaucrat can expect to gain something from the growth of his bureau; it is a rare bureaucrat who would lose as a result of budgetary expansion.

Therefore, the people who staff a bureau can be expected to develop and unite behind a strategy designed *to increase the size of bureau's budget*. Interestingly, this is true even if, as is often the case, the bureaucrats have burning desires to serve the mission of the bureau. Employees are often attracted to a bureau precisely because they want to promote the interest of the bureau's major clients. In addition, the bureau has a strong incentive to satisfy its clients because they often an important source of political clout. Thus, it is not surprising that bureau sometimes becomes, in effect, a lobbying agency for interests they serve.

Political competition would seem to provide legislators with incentive to curb inefficient performance by public sector suppliers. Legislators who promote the efficient operation of government bureaus might seem likely to reduce their vulnerability to a challenge by potential competitors. However, there are four major reasons why it will be extremely difficult for a legislative body to control the budget of a bureau and promote operational efficiency, particularly when the bureau is a monopoly supplier.

- *First bureaus do not have an easily identifiable "bottom line", analogous to the net income of a corporation that might be used to judge the bureaus performance. Neither do they produce easily quantifiable output that might be used to calculate per unit costs. The absence of a well-defined index of performance provides managers in the public sector with considerably more leeway to gloss over inefficiency and pursue personal objectives than is available to their counterparts in the market sector.*

- *Second, the major source of information with regard to the bureaus performance invariably comes from a biased source – the bureau itself.* While the managers of the bureau know far more about the costs of alternative outputs than anyone else, they also have a strong incentive to satisfy goals other than the minimizing cost. A hospital administrator wants the most elaborate equipment. A university wants the finest computer. Predictably, the bureau will supply the legislative body with information indicating that it is stretched to the limit, supplying an immensely valuable service at a rock bottom cost. Dire predictions for the fate of the bureau's clients, or for society as a whole, will be projected if the bureau's budget is not increased. Of course, legislators know that bureau chiefs follow this strategy. Nonetheless, because they generally lack solid evidence capable of contradicting the bureaus cost estimates, legislators will find it difficult to restrain the bureau.
- *Third, legislative control is complicated because inefficient performance does not lead to the termination of an activity in the public sector.* If private business incurs costs in excess of the value of the service it provides, bankruptcy will eventually bring the operation to a halt. The public sector lacks a parallel process for controlling inefficiency and halting unsuccessful experiments. In fact, failure to meet objectives often generates pressure for larger appropriations in the public sector. If the crime rate is rising, the crime presentation agencies will lobby for additional funds. If illegitimacy rate is soaring, the welfare industry will demand more funds for Aid For Dependent Children in USA.
- *Fourth, bureaucrats and their clients often form powerful coalition pressing for enlargement of the budget.* Because bureau employees and clients are highly concentrated, their interests are likely to be politically more effective than those of widely dispersed taxpayers. Of course, interest groups served by the bureau can be expected to be at the forefront of those advocating an expansion in the bureau's budget. In addition, the bureaucrats themselves may be a political force with which to reckon. Thus, the demand of persons supplying bureau services will supplement the demand of those receiving services from the bureau. Together, these forces will tend to result in overproduction of a bureau's output.

Beyond these reasons why it would be difficult for a legislative body to promote efficiency within the bureaus it oversees, *it is questionable how truly interested the legislature would be in bureau efficiency.* To a substantial degree, oversight committees are comprised of those legislators who have high demands for the services of the bureaus they oversee. Agricultural committees, for example, are likely to be staffed by legislators from rural areas; banking from areas with strong concentration of financial institutions. As a result, oversight committees are more likely to favour larger budgets for the functions they oversee than the rest of the legislature.

In summary, economic analysis indicates *the bureaucrats confront a perverse incentive structure that will lead to both high per unit costs and a rate of output for which the marginal value of the bureaus output is less than its cost.* It is important to note that the fault lies with the organization structure and not with the char-

acteristic of public sector employees. On the whole there is no reason to think that government employees are less competent, lazier, or less committed to their work than other workers. Nonetheless, given the incentive structure under which they toil, bureaucratic inefficiency is a predictable result. The government and its bureaucrats control a large portion of national income GDP and a large number of people are employed by government. (See Table 6-1 which shows social expenditures in Hungary.)

**Table 6-1.**  
Social expenditures in Hungary 1991 – 1999  
(Percentage of GDP)

	1991	1995	1998	1999 modified estimates
Education	5,6	5,2	4,8	4,4
Health	5,5	4,4	4,6	4,3
Social insurance, social and welfare services	20,7	17,4	15,2	14,9
Housing, settlements and regions	4,0	1,9	1,4	1,1
Leisure, culture	1,7	1,7	1,2	1,2
Environmental protection	0,7	0,8	1,0	1,0
Social expenditures total	<b>38,2</b>	<b>31,2</b>	<b>28,1</b>	<b>27,0</b>

*Source: Hungarian Ministry of Finance*

Therefore, improving bureaucratic efficiency can save a substantial amount of national resources that can be used to finance important new national targets. That is why the Hungarian government has set as a fundamental objective of the public administration reform:

- to increase the efficiency and improve the quality of the administration work and to reinforce its service providing nature;
- to replace the sometimes superfluous, too complicated bureaucratic, difficult public administration by a smaller, simpler, faster, more cost-efficient administration that performs the necessary public tasks with better qualified, recognized stable personnel. (Public Administration Reform Program of the Hungarian Government. 1996)

Monopoly is at the core of bureaucratic inefficiency. Since bureau suppliers are generally monopolists, legislative monitors do not have alternative suppliers to provide a basis for evaluating their cost effectiveness.

The response to traditional public administration and problems of bureaucratic inefficiency led in several directions. First, over a generation ago a movement for new models and approaches to public administration began. More recently *decen-*

tralization and *contracting out* were offered as an alternative to bureau production. We next look at these various new approaches and reforms.

### **New Approaches in Public Administration**

After the World War II, “heterodoxy replaced orthodoxy” (in Fry, 1989.), as Dwight Waldo argued. Different theoretical approaches and practical experiences influenced administrative organizations. Public administration is the arena where most major issues of policy making are resolved. The policy focus led to newer and more complex views of public administration. The organizational theories could not reveal important social and political determinants of governmental administration. An analysis of the relationship between public administration and the social and political actors that depend on it is needed to focus on how bargains are struck among the parties that gain advantage by such arrangements. “Acknowledging that policy discretion, specialization, professionalism, and the absence of clearly specified policy mandates have made agencies the center of the policy struggle, it is worthwhile to examine some alternative explanations of why policy rewards are dispensed the way they are under such conditions.” (Morrow, *Ibid.*, p. 89.)

Four models can be identified that link public administration to public policy:

- **Group model:** public policy can best be explained by competition among interest groups; that is characterized by bargaining among groups and legislators and administrators involved in the issue (this is the “*iron triangle*”); that this bargaining nearly always results in compromise among the interests; that such compromises represent the most practical view of the “common good” or “public interest”.
- **Elite model:** public policy represents essentially the values and strategic talents of elites that comprise the leaders of the major public and private organizations. It assumes that the public has no motivation or capability to provide effective policy leadership.
- **Incremental model:** regularities of policy making reflect rather minor variations on past programs. In this model the administrators do not regularly consider the rationale underlying most programs through careful identification of goals, by researching alternatives to existing policies and ranking them according to their relative contribution to the solution of problems, and by considering all available information that contributes to the relevance of each alternatives. Instead, they “muddle through”, as Charles Lindblom argued. (Lindblom, 1959.)
- **Systems model:** uses the terminology and approach of system-analysis, connecting the policy responses of a political system to factors in its environment. Environmental factors are those external conditions like culture, education, sociological aspects, and economic factors. The system model also includes the internal elements of the policy process and the feedback loop. This approach



also represents a replacement of the traditional “iron triangle” with the more complex, explanatory term of “policy subsystem”.

### *The New Public Administration*

Dwight Waldo, a brilliant thinker about public administration in the postwar period, challenged the dichotomy of administration and politics. He emphasized that the theory of public administration cannot be value-free in two senses. First is the cultural determination of the administrative systems. *Comparative public administration* is that promising area of study that presents the cultural diversity of different systems. “Comparative public administration, according to Waldo, taught us much about the relationship between administration and social ends, the critical dependence of civilization on effective governmental administration to other cultures.” (Fry, *Ibid.*, p. 232.) At the same time, Waldo criticized comparative public administration because it failed to produce anything in the way of rigorous theory.” (Waldo, 1980. p. 127.) As Fry interprets Waldo, “The pressure for practical results led to a switch from comparative to a ‘developmental’ administration... The results have not been much more encouraging. We have simply learned much about what *will* not work, and no general ‘science of development’ has yet emerged. Waldo charges that the developmental perspective has assumed that to be developed is to be ‘Western’.” (Fry, *Ibid.*, p. 233.)

A second set of issues concerned the democratic, social, and political engagements of modern public administration. Waldo confessed his sympathy for the New Public Administration (NPA) movement of the late 1960s and early 1970s. NPA criticized public administration for its lack of an explicit ideological framework and supported an activist role for the administrator in the pursuit of social equity. The basic principles of the New Public Administration were the *participation, decentralization and representative bureaucracy*. Participation was to be a means for promoting change and dispersing power within the organization. Decentralization was intended to increase citizen involvement in governmental and organizational processes. Representative bureaucracy was meant to produce client-centered administration and the representation of clientele interests by administrators.

### *New Public Management*

The 1980s and early 1990s saw the emergence of a new managerial approach in the public sector, in response to the inadequacies of the previous models of administration. (Hughes, *Ibid.*, p. 58.) The name of it, “*New Public Management*” (NPM), which differs from the earlier public management, was a technical sub-field of public administration. New public management emphasizes economy, efficiency and effectiveness of government organizations, instruments and programs and higher quality service delivery. Less attention is paid to compliance with formally prescribed processes, rules and procedures. The intent of NPM is to “free up” controls over and “devolve” greater responsibility to operating managers, to create additional “flexibility” or autonomy for managers, to allow public sector managers to manage, to place a greater focus on risk management and to focus on measuring perform-



ance. (OECD, PUMA, 1996. p. 106.) Government functions are more likely to face market tests, such as contracting out. Under NPM, government involvement need not always mean government provision through bureaucratic means. There is also a trend toward reducing government through privatization. The NPM is not a reform of the traditional public administration, but is a *transformation* of the public sector and its relationship with government and society.

According to Hughes, the main reason for the eclipse of the old traditional models of administration were simply that they did not work any more, and were widely perceived as failing. Governments began to hire economists or people trained in management instead of generalist administrators, borrowed management techniques from the private sector, pushed back the dividing line between private and public sector activity with the aim of cutting costs, and set out to change working conditions inside the system that were no longer required. Governments were faced with declining revenue, but with political demands to maintain services at the same level.

### **Attempts to Enhance the Responsibility and Responsiveness of Bureaucrats.**

There are serious needs and demands in democratic society that call for accountability of administrative decisions and bureaucratic actions. Attempts to clarify meaning and practice of accountability are numerous. There are elaborated theoretical approaches like the one of Etzioni (1995), who distinguishes between

- a symbolical use of accountability, when it is used as a gesture only,
- a political use of accountability, when administrators react to pressures of particular interest groups,
- a formal use of accountability, when the institutionalized system of check and balances is analyzed,
- and the use of accountability within his “guided-approach” which integrates the above-maintained factors plus a moral base in an interactive perspective. (Etzioni, 1995)

Bureaucratic actors may be responsible for the fulfilment of certain public tasks, but their performance is accountable if, and only if, it is responsive to legitimate sources of authority and influence. The public at large, elected representatives and pressure groups, as well as the intended recipients and actual clients of services, are considered as authorities to whom bureaucracy should be responsive. In the relevant literature both public interest and the interests of groups and individuals are cited as legitimate demands to which bureaucracies have to respond; public welfare as well individual welfare are seen as normative guidelines for administrative performance. This is the reason for the characteristic ambivalence in the production of many public goods and services: it is legitimated with the particular interests of declared target groups, but at the same time based on assumptions of some collective significance or utility that are not necessarily shared by all participating or affected actors.

Consequently, public bureaucracies are confronted with a multitude of legitimate sources of authority and influence and, thus, with a variety of interests which do not necessarily coincide. *Accountability of public administration then appears to have as many “faces” as there are different interests in the public sector and reflects by this its policentric structure. There are, for example, national federal interests; there are community-wide and group-specific interests, organized and private ones.* The variety of political pressures that derived from these interests poses serious problem to public administrators, frequently characterized in terms of a “multiple dilemma”, as there will be no commonly accepted output of bureaucratic performance, if there are several, mutually conflicting, but nevertheless legitimate, yardsticks for its success or failure. The tensions that arise from this problem are at least partly reflected in several politically set standards, which serve as operational measures for administrative performance.

*First, there is the dominant principle of legality (compliance with law).* Bureaucratic actors are expected to comply with a continuously expanding analogue of administrative rules and regulations. *This legal accountability refers to correctness of bureaucratic performance and, as well as to its uniformity and reliability.* Nevertheless, quality and quantity of formal rules usually leave more or less room for administrative discretion, which has proved to be necessary for a solution of complex tasks, but is also frequently condemned to result in misguided, unquotable, or even illegal performance. In order to improve the situation in this field, the Hungarian government intends to:

decrease or simplify the authorial activities via the comprehensive review of the authorial licensing procedures; review the procedural law of the state administration (passed in 1957 and amended several times) and numerous special procedural rules and to make suggestions aiming at the better harmonization of such rules. (Public Administration Reform Program of the Hungarian Government. 1996)

*Second, public bureaucracies, by definition, do not work according to the principle of maximizing profit but they are expected to maximize costs and to use their resources carefully.* Hence, economy (money saving) and – sometimes – efficiency (ratio of output per input) serve as an additional yardstick in terms of fiscal accountability. Nevertheless, examples of insufficient productivity and waste in public bureaucracies come to light almost every day. However, public bureaucracies should also be confronted with questions such as “Have the intended goals been reached?” and “Do outputs justify expended resources?” In the case of Hungary, in order to improve the effectiveness and cost efficiency of public administration organs, more attention will be paid to management and governance to work organization responsibilities, which can be underscored by the broad dissemination of modern organization methods and techniques? The cost-saving feature of the Treasury and public procurement systems (both established in the course of the public finance reform) will be further enhanced; and the self-regulation of market and society,

the self-assistance supported by the public and the self-organization, will replace the state regulation, if the right conditions are available or can be created. (Public Administration Reform Program of the Hungarian Government. 1996)

*The third standard is effectiveness (achieved outputs in comparison with declared goals), which addresses problems of political accountability or program accountability.* In Hungary, for example, the presence of excess capacity in the health service system, and particularly in acute hospital care, continues to be a major cause of inefficiency, of financial shortages, and ultimately of poor quality services. In Hungary in 1993, there were 101 hospital beds per 10, 000 population; the average for EU countries, where per capita budgets for health are significantly higher than in Hungary, were 90 beds per 10, 000 in the same year. Reducing excess capacity is a *sin que non* for successful health reform, and the government's program recognizes this.

*The fourth standard of accountability is called representativeness to the needs, problems, and preferences of citizens as members of target groups or of the actual clientele of public services.* This criterion has been brought into prominence, with steadily growing emphases during the last decade. Nevertheless, there are still more than enough public complaints about irrelevance, inadequance, and failure of bureaucratic performance in light of this modern standard of "public relations". Still, there is much evidence that even universal services apply selective, and sometimes even discriminating, intake and treatment procedures. But on the other hand, there is also the danger that the standards of responsiveness and equity or equality, but also of effectiveness and efficiency, may conflict if one tries to standardize personal services and to deliver them regardless of personal user characteristics.

*All of these standards refer to different aspects of performance. They represent a set of goals that are not in hierarchical order, so that none of them can be maximized without restricting the fulfilment of the others.* In the ideal case there should be a balanced equilibrium of all standards to ensure that each may compensate for the deficiencies of others, but some standard are always promoted by sacrificing others. *In this sense we have to speak of competing standards in public administration, which reflect the conflicting interests in the public sector on a formalized, abstract level.* Addressing divergent demands and making it responsible for adequate responses to them implies the transformation of political and social conflicts into its administration, and there cannot be doubt that administrators will react primarily to those interests and satisfy the needs of those actors who wield most political and social power.

*Effective (public) influences on bureaucratic performance have to be and are in most cases legitimated in formal system of checks and balances.* It is the dominant criterion in the reality of public administration, mainly because it is the criterion of legality. It requires responsiveness to citizen's needs. It is linked to demands for more citizen participation in the production of public goods and service.

### **Citizen Participation**

Bureaucratic accountability and especially responsiveness to citizen's concerns can only be achieved on the condition that there are adequate perceptions of public needs and demands (detection and definition of problems), appropriate transformation of articulated claims into political goals and programs (political formulation and implementation), and effective corrections of service delivery in case of program failure or environment change (learning and reacting on basis of feedback).

This requires *appropriate linkages between public bureaucracies and publics*: open communication channels which allow citizens to get their interest incorporated into the political system and effective control mechanisms which ensure that these interest do not get lost in the various phases and stages of the political and administrative process. In Hungary the following steps have been taken in this direction:

- for promotion of public objectives, the public administration organs endeavor to establish co-operation and partnership with other relevant organs and persons beyond the scope of their public authority or government competence (agreement of the public and private sector for the use of the voluntary supports of the private sector);
- in certain cases, public functions are performed by public foundation or public interest companies or by nonprofit private organizations. (Public Administration Reform Program of the Hungarian Government. Budapest. September 1996)

The question of what opportunities citizens have to control bureaucratic performance must be discussed with regard to three different levels on which citizens may have a roles to play? They may play a role:

- as members of state or the citizens in general (constitutional level),
- as members of political pressure or target groups (political level),
- as member of political agency's clientele (street-level of administrative reality).

The role that citizens can play at constitutional and political level, for example voting, is very essential for modern democratic states, for the legitimization of rulers for example; but there are limitations. For example, periodical election of parliamentary representatives is of limited value for an effective public control of the specific processes of policy formulation and bureaucratic delivery – at least in the absence of referenda on particular issues. This places more emphasis on the street level, on individual representation, and on participation in policy-making and policy-implementation.

The forms and content of citizen participation are numerous and variable, but at least two general types can be distinguished

- *ad hoc groups of citizens* who are directly affected by administrative performance and more or less *organized interest groups*, both trying to exercise informal political pressure upon governments and administration from outside;

- *citizens as members of advisory committees* at the state or local level or as members *in public organizations's management boards*, exercising evaluation and control from the inside or even the top of administrative agencies.

Problems of policy-making and policy-implementation in connection with citizen participation cannot be discussed without looking at the important role street-level bureaucrats and citizens play as producers and co-producers of public goods and services in bureaucratic encounters when state and citizens meet directly, if not to say “personally”. One of the forms in which this occurs is co-production, which can be described in terms of *three different dimensions of individual co-production*:

*First, citizens control important inputs of service delivery* (services like emergency assistance from fire, police, or medical personal is usually initiated by citizen request). Without citizens ‘s articulation of needs, most of these services will not be delivered.

*Second, citizens are an integral “production factor” in the administrative input of bureaucratic encounters, where the specific resources, motivation, and skill of both citizens and bureaucrats are transferred into joint inputs.* Teachers cannot produce education without the collaboration of pupils. Police officers depend on the support of citizens with regard to successful crime investigations, and welfare officers need accurate description of individual needs to be able to provide adequate help.

*Third, coproduction by citizens* – in interaction, with their personal social environment – *produce follow-up impacts of public service delivery* by transforming or incorporating the output, which are provided by administrative agencies or which have been (co)-producing in bureaucratic encounters, into more or less effective routines of everyday problem-solving. For example, children’s allowances received from welfare offices may improve children’s living conditions, if spent appropriately by their parents. Competencies and skills gained in vocational training programs may improve individual welfare, if they are used to find in a new job and to retain it.

It can be concluded that the implementation of coproductive arrangements is an important challenge for the public sector, because it may imply both devolving service responsibilities and improving the responsiveness of bureaucratic performance, thereby producing more efficient public service. In Hungary, for example, small independent local self-governments can be supplemented by different associations, and hence allow the performance of the public tasks in a professionally more effective and more cost-efficient manner. Different types of voluntary, special purpose association, co-operation forms can be introduced (for example, professional working group, special purpose association, joint organization in fields of health care, education, infrastructure) (Public Administration Reform Program of the Hungarian Government. Budapest. September 1996).

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# Chapter 7



# **The Role of the Nonprofit Sector in Public Policy**

*Pavol Fric and Martin Bútorá*

## **Introduction**

In the last decade, the significance of the nonprofit organizations – the so-called “third sector” – has literally grown all over the world, from the advanced countries of Western Europe, North America and Asia, to countries of the former Soviet bloc and developing countries in Africa, Asia, and Latin America.

The growth in the inexhaustible number of nonprofit organizations (NPOs), the boom in associating and voluntary activity belongs to the great social innovation at the end of the 20<sup>th</sup> century. It does not concern America only, far from it: this kind of organization has emerged in almost every part of the world in the last decades. Two leading theoreticians, Lester Salamon and Helmuth Anheier (1996) speak about the third sector as of “a new global power”. No one knows exactly how many nonprofit organizations besides the governmental ones exist round the world at present, writes Jessica Matthews (1997).

This fast growing universe comprises diverse groups of people: groups of neighbors, interest groups, professional groups, organizations rendering services, acting for the defence of certain principles or rights of groups of citizens, groups of religious as well as secular character. They are supported by donations, contributions from the state, international organizations or by marketing their own products and services. They range from the smallest village associations to influential international groups, such as Amnesty International, global organizations of the type Greenpeace, or the giant service provider CARE with the annual budget of \$400 million, except China, Middle East and some other countries, where cultural factors or autocratic governments limit the civil society. While some more traditional groups in the United Kingdom (scouts, some church organizations) suffered from a decline in the number of members, the rise in the power and number of other, newer ones is surprising write the British authors Geoff Mulgan and Charles Landry, calling the third sector “another invisible hand” (i. e., besides “that of the invisible hand of market”). The charitable impulse is still here, only its forms have changed. The boom is expressing “the urgent need to belong to somewhere, take part in something, change something”; the relative prosperity sets the people’s hands free to cultivate their values and materialize enthusiasm. (Mulgan – Landry, 1995)

The names of the three studies quoted – New global power, Change in power, Another invisible hand – reflect the massive scale, drive and flourishing of the phenomenon so much fascinating social scientists, now and then giving a headache to politicians, and being the work of involved citizens. These titles reflect the revolution in associating the effort of millions of people around the entire world to participate in something making sense, something though often bringing benefits

for them alone, is generally serving the public welfare and exceeding individual human lives and horizons.

### **The Role and Scope of Nonprofit Organizations**

Nonprofit organizations are enormously different from each other in their size and scope of activity, ranging from community and neighborhood organizations with no property and employees, to many billion worth foundations, universities and health care complexes with thousands of employees (Hall, 1995). They are enormously different in what they do – from offering traditional charity aid to those socially in need, manufacturing all kinds of products to executing qualified survey.

The diversity of the sector is reflected in many terms used for its description. Each one of the commonly used terms points out a certain aspect of its character: “third sector” (as a sector active between the state and the market), “nonprofit sector,” “voluntary sector,” “public-service sector,” non-governmental organizations (internationally referred to as NGOs), “non-state organizations” (i. e., organizations of a non-state character), “charity (humanitarian, philanthropic) organizations,” “self-help groups, clubs, organizations”, the British term “non-statutory sector” (i. e., not required by law, non-compulsory), or “informal sector,” the American term “tax-exempt sector”, the French term “économie sociale” (used in France and Belgium, and increasingly, in European Union institutions), or German terms such as “gemeinnützige Organisationen” and “gemeinwirtschaftliche Unternehmen.” (Anheier – Seibel, 1990)

The “civil” dimension; i. e., a strong relationship to the building of a civil society, is particularly significant. A common proclamation of key figures from all over the world, theorists, practitioners, and other experts in this area, called *Toward a Vital Voluntary Sector*, say that “the voluntary sector is built upon the values of independence, personal initiative, pluralism, and solidarity”. According to its signatories, voluntary organizations help to fulfil material, social, psychological, spiritual, and other needs and desires that cannot be satisfied by the state or market. These organizations enable individuals to associate in order to promote common interests, protect the rights of groups and individuals, to support specific projects aiming at improving the quality of life.

The term “civil society” has gained various meanings during – from “an arena, independent of state, where autonomous civic initiatives could emerge” through “a liberating force against the oppressive state” to “a space for critical discourse in which citizen attitudes and virtues could be exercised”. (Bozóki – Sükosd, 1993) After the fall of communism, the situation in the former socialist countries has changed: several movements, which had existed in the framework of a broadly understood civil society, have gradually transformed into political parties. These, to a great extent, have attracted the intellectual potential that had previously been involved in the network of a civil society. (Fisher, 1992) According to Bozóki, it took several years before the meaning of a civil society changed: “it is not a rebellion against the oppressive state any more, but a self-organizing society living besides the

democratic state” with the emphasis of its activity relying upon non-governmental organizations and the nonprofit sector.”(Bozóki – Sükösd, 1993)

Similarly Michael Foley and Bob Edwards distinguish “two broad families of the “civil society argument”. The first, crystallized in Alexis de Tocqueville’s famous study of *Democracy in America*, puts a special emphasis on the socializing effects of associations, on the ability of associational life in general and the habits of association in particular to generate patterns of civility in the actions of citizens of the democratic state. The second, articulated most forcefully by Jacek Kuron and Adam Michnik and their associates in formulating a strategy for resistance to Poland’s communist regime, but also evident in recent literature on processes of “re-democratization” in Latin America, lays special emphasis on civil society as a sphere of action independent of the state and capable precisely for this reason of energizing resistance to a tyrannical state.” The first concept “postulates the positive effects of association for democratic governance”, the latter “emphasizes the importance of civil associations as a counterweight to the state.” In non-democratic regimes, there is always a tendency to create “parallel structures” (parallel forms of education, of culture, parallel trade unions, information networks etc. as a base for a “parallel polis” – the term comes from Václav Benda). In emerging democracies, the NPOs help to establish the rule of law, to guarantee human rights, to prevent conflicts, to involve citizens in democracy through participation etc. (Foley – Edwards, 1996, and also Coble, 1995)

Issues related to the nonprofit sector and civil society continue to attract the attention of politicians and theorists in many post-communist countries. For instance, Václav Havel sees the third sector as a special layer of society which “is mostly not private, but should not be of state character either, which is not profit-oriented, but of crucial importance for society”. He considers a flourishing third sector as an “indispensable part of a mature civil society, even as an indicator of its maturity.” (Havel, 1994) He points out, in this respect, that democracy can also be improved when the interests of people are not only promoted by political parties, but also by non-political units of a civil society.

In contrast, some advocates of a liberal democratic model of democracy are concerned about the involvement of non-political entities in a civil society in politics because, according to them, it could weaken political parties, which are the most important promoter of the interests and serve as the “principal mechanism for the articulation, manifestation, aggregation, representation, and promotion of these interests.” (Brokl, 1996 ab) If the third sector is understood as a buffer zone existing between the state and society in order to reduce social tensions and political conflicts, then the role of the mentioned traditional political mediators; i. e., political parties, is reduced. Through such “overlapping”, the original liberal democratic system could lose its flexibility and the “creative harmony of the plurality of powers” would be limited.

Similarly as Mancur Olson, some proponents of a liberal democratic model see rather in the “dense web of associations” an enduring threat to the smooth and

equitable functioning of modern states and markets alike. (Foley – Edwards, 1996, and also Coble, 1995) In this respect, a strong civil society is more of a burden for a liberal democratic state and presents a similar threat to such a system as to an authoritarian state; (Foley – Edwards, 1996, and also Coble, 1995) associations basically put democracy in jeopardy because they “intermediate and represent a partial interest (professional, group) and not a general, aggregated and political interest. It is difficult to translate this partial interest to the broad public. It lacks transparency and thus, cannot be controlled by a broad (i. e. political) public (Brokl, 1996 ab).

If we return to our ideas on the two “basic types” of a civil society, we can articulate a hypothesis that in CEE countries undergoing the transformation process, the formation of the first type of civil society (i. e., as a self-organized society existing in harmony with a democratic state, as a space involving citizens in the process of “building a democratic state”), will be determined by the degree, to which the state actually will be democratic. In contrast, a growing presence of autocratic, authoritarian, and undemocratic features in the existing regime will probably result in efforts of a civil society to be independent, to resist all forms of state-like oppression.

### **Legal Issues**

A **civil association** can be defined as an organization of people, bound by a common interest, who, in order to pursue this interest, have found it appropriate, useful, and practical to associate their activity and possibly (though not necessarily) their property. (Frič, Deverová, Pajas and Šilhánová, 1998) Sometimes also named alliances, societies, or clubs, they account for the majority of nonprofit organizations in the CEE countries and represent the fundamental means to utilize the constitutional right of assembly. Decision-making in civil associations is usually executed by voting of its particular members or by elected committee.

In contrast to civil associations, which are based on the membership principle, **foundations and funds** are associations of property serving public benefit purposes. In general, foundations are required to have an endowment consisting of either cash kept in a special bank account, real estate or other assets that generate substantial income. Endowment assets must be registered and may not be sold. Only the income, but not the assets themselves, may be used for the foundation’s purposes. The basic difference between a foundation and a fund is that a fund does not have a registered endowment. (Frič, Deverová, Pajas and Šilhánová, 1998)

The legal treatment of **churches and religious congregations** is based on freedom of speech and the freedom to disseminate religion or faith. On the other hand there may be a minimum membership requirements for registration purposes of these organizations. For example in the Czech Republic (see Frič, Deverová, Pajas a Šilhánová, 1998) a church may apply for registration if it has a minimum of 10, 000 members of age who are permanent residents of the Czech Republic or if it is a member of the World Council of Churches and has at least 500 persons of age

who are permanent residents of the Czech Republic and who profess to support it. (Frič, Deverová, Pajas a Šilhánová, 1998)

**Private Nonprofit Organizations / Public Benefit Corporations** are established mainly for the purposes of public services providing. These organizations are openly allowed to run business activities in condition that any profit have to be used for the extension of the services for which the organization was established. They are set up, at the behest of the founders, by its articles of association or its founding charter. Any natural person or legal entity, including the state, may be a founder.

### *Government Nonprofit Sector*

While the former types of organizations are clearly regarded as part of the CEE countries nonprofit sector, there are a number of borderline cases that are either not usually identified as part of the sector or show characteristics that call their “nonprofit” nature into question. These include cooperatives, interest associations of legal entities, companies, budgetary and contributory organizations, political parties, and trade unions.

After the end of World War II, power in the CEE countries was taken by totalitarian communist parties. In time, following the example set by Soviet Union, the overwhelming majority of independent nonprofit organizations was either closed down or centralized and fully in control of communist party and in many a case even totally nationalized. The organizations nationalized were those, where the communist government in line with its ideology felt the need to guarantee – by the law – the “working people” to be provided with some services (above all, social or health care ones), or, wanted to use them for its own political benefit (mostly in the area of schools). The legal form of nationalized organizations rendering social, health care and educational services became budgetary and contributory organizations, which still exists in the CEE countries today and in their activities compete to NPOs. In the areas, where they are active, they so far represent the dominant form of providing services and managing problems of citizens. Because the state is their founder, it gives them annually an important part of money to the running of these organizations.

*“Budgetary organizations are state bodies that have their income and expenses specified in separate line items of the state budget for that year, Examples include individual ministries, the Constitutional Court of the Czech Republic, the Academy of Sciences, hospitals, state schools, museums, and research institutes. Budgetary organizations are entirely financed by the state and must return any unused funds as well as any revenues resulting from their own activities to the state budget at the end of the year...A contributory organization (sometimes also referred as a “subsidiary organization”) has elements in common with budgetary organizations. Although the state contribution may represent the largest portion of its budget, not all its expenses are covered by the state. These*

*organizations are usually established to fulfil cultural and educational functions by other government entities.” “Contributory organizations may have income in addition to the government subsidies to cover their expenditures, but any net income earned during the fiscal year may be fully or partially withdrawn by the founding government entity or left in a reserve fund of the organization. Such a decision is fully in the hands of the founder and the organization has no means to influence it. The position of a director of a contributory organization would be very weak in any confrontation with the founder, because the founder may remove the director without any explanation or reason. Budgetary and contributory organizations can be set up by the central bodies, county councils, and municipalities. The main difference between budgetary and contributory organizations is mainly the degree to which they receive financial resources from state, county, or municipal budgets.” (Frič, Deverová, Pajas and Šilhánová, 1998)*

### *Legal Traditions*

According to Hrubala (1998, pp. 174), in the CEE countries there exist three law traditions having influenced the building of the legal background of NPOs functioning in this region. The first and foremost of them, according to him, is the tradition of the continental Europe law (civil law). By this tradition, the accepted legal form the initiative of citizens takes on, would determine the kind of responsibilities and advantages or benefits (e. g., tax allowances) this subject will have. In the spirit of this tradition, the decisive moment from this point of view plays the sheer act of registering the civil activity under a certain legal form. The second, so-called, Anglo-American law tradition based on the precedent type of law (common law) is in the area of nonprofit law rather than on the legal form focused on the purpose of existence of the legal subject concerned (NPO). In view of acquiring the right for the benefits and privileges of charity organization the decision on the purpose is more important than its registration. The third tradition, by force of habit, still influencing the life of nonprofit organizations in the CEE countries is that of Soviet law. The spirit of the Soviet tradition in these countries can be observed in the tendency to produce special laws with special conditions for a very limited group of organizations, or, for individual organizations only.

### *Taxation*

The legal systems in all CCE countries take into account the fact that NPOs are organizations, which, because of their social mission, must be given better tax conditions than those of commercial, profit subjects (companies). The beneficial tax treatment can concern not only NPOs alone, but also donors contributing to public benefit (welfare) purposes. In case of NPOs, tax allowances can be reflected in income tax (NPOs can be partially or totally exempt from income tax) on the activities they fulfil their mission through (“the nonprofit” activities they have registered in their status) as well as on the business activities. The tax beneficial



treatment can apply to property tax, transfer tax, indirect tax, and value added tax, tax on importation or sales tax. In case of donors contributing to public benefit purposes, in the countries with established democracy and in all CEE countries there exist an option to write these donations off the tax base of donors; this arrangement encourages their willingness to contribute to activities of NPOs. One good example is Hungary as shown in the following box:

**Hungarian tax law of one per cent**

In December 1996 the Hungarian Parliament passed the bill allowing taxpayers give from their personal tax on income a maximum - 1% (which is in total about 4 billion forints) directly to a nonprofit organization or cultural institution of national importance. Taxpayers alone decide giving the organization 1% of their tax on income. Although the total sum collected from this one per cent covers a relatively small part (less than 10%) of all funds the Hungarian nonprofit sector acquires from the private sphere, this law is a very important mechanism. The distribution of funds by means of this rule is dramatically different from that of funds from public resources by means of other mechanisms. Local, smaller organizations, which were set up on the basis of specific, local needs and which only with difficulty get to grants or orders of large, governmental agencies are now supported by those living with them, perceiving the same problems and therefore able to participate in coping with them, which, ultimately, turn to their benefit, too.

(Guide of third sector, 1997)

*Restrictions and Accountability*

Legal theory treats nonprofit organizations as entities that are not primarily established for the purpose of business and that do not divide their profit among their founders, members of their statutory bodies but rather use it for the organization's further development. This is the key distinction between nonprofit and for-profit organizations and has been characterised as the "non-distribution constraint" (Hansman, 1980, 838). Beneficial tax status brings with itself a certain restrictions. According Salamon and Flaherty these restrictions are concerning mainly the conflict interests problem. NPOs members or employees are usually prohibited to do some transactions:

- a loan of money or other valuables by nonprofit to a private individual,
- assumption by the nonprofit of liabilities of an individual,
- payment to an individual or business of amounts in excess of what would be normal, reasonable compensation for goods or services provided for a nonprofit's organization

- granting a private person permission use or purchase nonprofit facilities or office supplies and equipment at no cost, or low-cost, and
- use of the nonprofit form to operate a for-profit business or to serve business purposes (e. g., allowing a foundation to invest in a business controlled by a board member).” (Salamon and Flaherty, 1996)

Nonprofit law system therefore may require some degree of transparency of NPOs. The “purpose of such requirements is to provide a means of confirming, through periodic reporting and disclosure, that nonprofit organization is in fact conducting activities consistent with its purposes and beneficial tax status and devoting its financial resources to the fulfilment of those purposes.” (Salamon and Flaherty, 1996)

### **Characteristics of NPOs**

According to the “structural/operational definition” of NPOs proposed by Salamon and Anheier (1992), organizations that are commonly included in the nonprofit sector are distinguished by having the following attributes:

#### *Organization*

Organizations must be institutionalized to a certain extent, primarily via a written document (statutes or organizational code). Nonetheless, institutionalisation may also be demonstrated in other ways – for example holding regular meetings of members and representatives, or following procedural rules or other forms of structured activities. This criterion is generally applicable to all organizations in the CEE countries nonprofit sector.

#### *Private*

Private organizations are institutionally separate from the state apparatus and public administration. NPOs are neither part of public administration nor are they managed by state administration or administrative boards in which state officials predominate. At present, this criterion will serve to exclude budgetary and contributory organizations from the analysis, because both types of organizations are considered state or municipal organizations. It is very likely, however, that over the next few years these organizations will be transformed into nonprofit organizations providing public benefit services and will most likely take the form of public benefit corporations.

#### *Do not distribute profits*

NPOs do not distribute profits among owners, members or administrators. Although nonprofit organizations may accumulate profit, this profit must be used exclusively to support the basic objective of the organization. In this sense, private nonprofit organizations have a primary purpose other than the creation of profit. Potential problems arise with regard to associations of legal entities and cooperatives, because both types of organizations may be established either for nonprofit or business purposes

### *Self-Governing*

This criterion requires organizations to be capable of managing themselves. Nonprofit organizations have their own internal management procedures and are not managed from outside. This criterion has relevance for a large number of establishments founded by churches and religious communities and congregations. The extent of their legal personality might be disputed due to their subordinate position with respect to the parent church or community, but their relative economic independence and their full independence from the state, together with their important role in the use of voluntary work for solidarity purposes, make them a respected, important, and welcome part of the nonprofit sector as well as an indispensable part of the civil society of the CEE countries.

### *Voluntary*

Nonprofit organizations make use of voluntary participation in their activities to a certain degree, either in the execution of the actual activities of the organization or in the management of its affairs. This does not mean that all, or a majority, of the organizations' income must come from voluntary contributions or that the majority of the members of the organization must be volunteers. The existence of a certain voluntary contribution or voluntary service as a member of the administrative board may suffice. This criterion will effectively exclude professional chambers, such as bar associations (which are self-governing professional organizations with mandatory membership) that grant approval to carry on certain professional activities and monitor their members. The chambers are considered as organizations not established for business purposes and they are similar to organizations in the nonprofit sector

As evident, not all organizations typically included in the nonprofit sector meet all the above characteristics. They are so-called borderline cases and the nonprofit community developed a number of abbreviations for their name, the basis of which is the letters NGO (hiding the name "Nongovernmental Organization"). These abbreviations often communicate the major resource of funding, or, dependence on the founder of organization. As an example, we can name at least the following ones:

**QUANGO** (Quasi Public Private NGO), and among them we can further specify:

**GONGO** (Governmentally Organized NGO), which, e.g., in the South American context would be called:

**GRINGO** (Governmentally Run and Inspired/Initiated NGO), also used is the abbreviation

**BONGO** (Business Organized NGO), sometimes they call like that NPOs founded by large business corporations.

## Theories of NPOs

Six major theories of NPOs are summarized and tested by Salamon and Anheier. (Salamon and Anheier, 1996b)

### 1. Heterogeneity Theory (Market Failure/Government Failure)

The starting point of this theory is the knowledge that the free market is not able to ensure the public goods for citizens in the desired extent, i. e., products and services generally available to all citizens regardless of whether they paid for them, or not. The typical example of this kind of service is, e. g., safety of citizens. In the failure of market to ensure the public goods the classic economy recognizes the reason for the existence of government. Where there exist major differences in the opinion of which public goods should the government ensure and which not, there will be very difficult for the government to win the majority support for their public policy, and therefore, many not saturated needs and demands for the public goods would continue to exist. Apparently, this “government failure” will more often happen in heterogeneous societies composed of many different social, religious, ethnic and other groups, than in those more homogeneous. In this situation, according to Weisbrod, people will start setting up NPOs to ensure the services and goods neither the market nor the government are able to provide to them. According to this theory, the cause of the origin of NPOs is social heterogeneity.

### 2. Supply-Side Theory (Social Entrepreneurs)

The supply-side theory refuses recognizing the failure of market and state as the sufficient conditions for the origin of NPOs. According to its main representative, Estelle James, for a satisfactory explanation of differences in the development of NPOs in the individual countries, we should take into account one more factor – the presence of “social entrepreneurs”, i. e., people, who have a special motivation and incentives to develop NPOs saturating the needs of citizens. (James, 1978) The occurrence of these social entrepreneurs, however, is not accidental. It is significantly more frequent, e. g., where there exists religious competition.

### 3. Trust theories (Contract Failure)

The trust theory sees the origin of NPOs in the failure of market, but, in a different sense of the word than the previous theory. The market does not fail so much not being able to saturate diverse needs of the population, but in not being able, in some cases, to make a credible enough environment for executing business transactions. This so-called, “contract failure” is based on the consumer often not having enough information to be able to judge the quality of goods and services they pay for. And the producer of goods and services does have this information, which results in “information asymmetry”, which, in the eye of the consumer, can be bridged only by the producer’s credibility. That is why consumers prefer choosing NPOs as the supplier of goods and services, as they do not come to

the market with one single intention only, i. e., to get as much profit as possible. (Hansman, 1980, 1987)

#### 4. Welfare State Theory (Nonprofit Sector as a Residual Category)

In spite of the fact that the first and foremost aim of the welfare state theory is not explaining the origin of NPOs, this theory had an immense effect on the thinking of the entire generation of social scientists about the significance of NPOs in society. In the light of this theory, NPOs are seen as a pre-modern mechanism of coping with social problems used mainly in traditional societies. With the arrival of industrialization and social policy of the state, however, it lost its significance and is still here only as a certain residuum of the old times. As Jill Quadagno says “as industrialization proceeds, it creates new needs for public spending by reducing the functions of the traditional family and by dislocating certain categories of individuals whose labour becomes surplus – the very young, the old, the sick, the disabled. . . Because traditional societal institutions are unable meet the needs of these vulnerable individuals, the state expands more or less automatically. . .” (1987, p. 112, quoted in Salamon and Anheier, 1996b, p. 16) The reason for NPOs continuing existence in the contemporary, modern world is nothing else but the not sufficiently developed functions of the state.

#### 5. Interdependence Theory (Voluntary Failure)

The interdependence theory does not see the reasons for the origin and functioning of NPOs one-sided in the areas of the state and market failure and refuses their inherent assumption of an inevitable conflict relationship between the state and NPOs. Far from it, it can find elements predetermining the state and NPOs to cooperation on both sides of this relationship. Simplifying we could say they mutually help compensate for their drawbacks and therefore are inter-dependent.

*“For one thing, nonprofit organizations are often active in a field before government can be mobilized to respond. They often develop expertise, structures, and experience that governments can draw on in their own activities. Beyond that, nonprofit organizations often mobilize the political support needed to stimulate government involvement, and this support can often be used to ensure a role for the nonprofit providers in the fields that government is persuaded to enter. Finally, for all their advantages, nonprofit organizations have their own significant limitations that constrain their ability to respond to public problems.” (Salamon and Anheier, 1996b, p. 17)*

#### 6. Social Origins Theory (Liberal, Social Democratic, Corporatist and Statist model)

Seeking the answers to the questions asking about the causes of NPOs origin, the Social Origin Theory asks us to examine the link between NPOs and particular social classes and functionality of this link with respect to the historical role

of these classes. Because, as Wolfgang Seibel says, NPOs “are not only providers of goods and services but important factors of social and political coordination.” (Seibel, 1990, p. 46) According to him, NPOs make sort of cores in the networks in the elites enjoying good reputation and having money and power. NPOs are not some socially released subjects absolutely freely moving in the society. By contrast, they are firmly fixed in its social and economic structure. Salamon and Anheier (1996b) recognize four models, or, as they call it “nonprofit regimes”, of NPOs placing in society.

First is the **liberal model**, typical of opposition to extending the inference of the state in social services, and instead preferring the solution lying in private initiative and voluntary work

Second and opposing the liberal model is the **social democratic model** preferring services delivered by the state and leaving only a very limited area for the service activities of NPOs. It occurs only where the labour class (supported by the allies from other classes) manages effectively influence the execution of power in the state.

Third is the **corporatist model**, where the strong state cultivates NPOs as the reservoir of the key social elites, which in the position of negotiators (mediators) is able to prevent more radical requirements of social welfare protection. The outcome is a relatively extensive nonprofit sector under the generously supported social programs by the state.

Fourth is the **statist model**, which is not tied to the labour class as was the case of the social democratic model. The state in this case is more likely to serve the interests of its own, or of those of the economic elites, and keeps a considerable degree of autonomy. NPOs are pushed out to the periphery of the social events as the representatives of marginal interests.

## **Explaining the Growth of the Nonprofit Sector in CEE Countries**

### *Supporting a faltering social welfare system*

The remarkable emergence of the nonprofit sector, which virtually did not exist in CEE countries just a few years ago, is a result of several factors. Some of these factors have occurred in various countries and various social systems. As it was summarized in recent material prepared by the European Foundation Centre for the European Commission in May 1996, over the last few decades, the growth of the third sector worldwide has been phenomenal. Foundations and associations enable citizens “to play an increasingly active role in all spheres of public life, sharing with government and the business community the task of building civil society”. This may be supported by statistical data. In the European Union, “the sector constitutes a powerful economic force at 4 – 5 percent of GDP. Some 10 million professionals are employed in social economy (i. e. in the third sector) helping to stimulate the work of 80 million volunteers. One in eight new jobs created in France, Germany or the UK is in the social economy; more than in

any other sector. With the decrease of trade union membership, foundations and associations are taking up their share in the social dialogue with government and business community.”(Gallop – Kemp, 1996)

Lester Salamon, a leading theoretician, speaks of an “associational revolution”. (Salamon and Anheier and Associates, 1998) One reason for it is a general crisis of the welfare state. In the West it is characterized by bureaucratic mechanisms and budget deficits. But it is not only a lack of financial resources for public social expenditures which has cast doubts upon the concept and practice of the welfare state: there has been an evident lack of a political consensus on the efficiency and transparency of the welfare state as well as of its capability to embrace new demands for providing services. In the case of the former Soviet bloc countries, there was a crisis of the socialist welfare state within the regimes of “real socialism” which were increasingly less capable to provide former advantages and to cope with new needs. Unlike in Poland, Romania or Hungary, the crisis in Czechoslovakia was not fully apparent before the fall of the Communist regime, but became more visible during the social transformation, which followed its collapse.

#### *The rise on the middle class*

Another factor is the rise of an active middle class, whether it is perceived as a group of potential providers of nonprofit services or as a group of potential clients. The former group involves more active, more imaginative producers, while the latter group is made up of more sophisticated, more demanding consumers.

#### *A participatory ethos*

This may be linked to a revival of the “participatory ethos” of the sixties. The basic thesis of this view is that in many spheres of society (e. g. housing, education or protection of the environment) the people who have a particular problem are an inseparable part of whatever solution may be developed. The participatory ethos was characteristic in CEE countries primarily in the environmental movement which became more visible during the second half of the 80s and which later formed one of the pillars of the anti-regime movement of citizens in 1989.

#### *Demand for specialized services*

More colourful ways of life in combination with the increasingly complicated nature of society at the end of the twentieth century have increased the demand for specialized activities. Thus, in humanitarian services, new forms of self-help have increasingly gained importance. Self-help has not only emerged in response to dissatisfaction with social or health services, but also as a creative response to problems which have not been solved and cannot be solved by family or other support systems. These are “new forms of social learning and of coping with various life circumstances.”

*Communications revolution*

Another universal stimulus is the communications revolution as a result of which ideas, knowledge, practices and techniques applied in the nonprofit sector have spread at a greater pace and with greater power throughout the world, attracting more and more people. The media as well as the people in CEE countries have opened themselves to the world to an incomparably greater extent than before and, quite naturally, they have also imported a colourful variety of experiences from the voluntary sector.

*Collective Identity Theory*

Another explanation is the theory of collective identity. (Melucci, 1988, 1989) In view of this theory, the collective identity represents for the individual a value per se. For the feeling of its sharing and participation in its building, its member is willing to sacrifice his/her own profit for the benefit of others. Because of that, he/she takes part in collective events and builds organizational structures supposed to ensure its persistence in time.

After the fall of the communist regime, the collective identity as such has become the value in short supply and very much in demand. Within the traditionally collectivist social environment in the CEE countries the values of individualism and to them relevant behaviour patterns can spread only very slowly. Therefore, so much typical of the post-totalitarian social climate is the hunger for collective identities to create the authentic reference frame of the behaviour of disoriented people. For those, having fought against the communist regime, or secretly rejected it, its fall meant the loss of the orientation point enabling them to be meaningfully ranked among the group of its opponents. And a great many of those having supported the regime, with its fall, definitely lost their belief in the meaningful nature of the Marx-Leninist ideology.

The collective identity theory proves people will be associating and organizing themselves also in cases when there is no failure of the state or of the market, which means, that also in case there are not spread any feelings of the market environment deficit or state intervention and no requirements raised on the state to ensure some needs of its citizens. The need of collective identity is often independent of these institutions, or focused against their activity, or rejecting their existence as such. In this sense, there used to be and still are established some NPOs in the CEE countries as the territory liberated from bureaucratic, dehumanised manners of the state apparatus, and/or from fierce and consumer practices of the market. The collective identity theory is thus able to explain also the origin of such NPOs being of sub-cultural or contra-cultural character.



## **The Role of the Nonprofit Sector in Society**

### *Functions of NPOs*

The importance of the nonprofit sector to society depends not only on the qualities the sector possesses, but also the use to which it puts them. Our concept of the sector's mission is based on the generally accepted view that the nonprofit sector is one of the three main pillars of modern society with its own identity and social function, which do not depend only on its relationship to the public and commercial sectors. Seen in this way, its role is irreplaceable, because it constitutes a separate social subsystem whose functions cannot, and indeed should not, be fulfilled by other subsystems. A detailed analysis of literature on the nonprofit sector shows that there are five distinct key functions (Salamon et al, 1999), which NPOs fulfil in society.

### *The service function*

Nonprofit organizations provide a wide variety of services not only for their own members or target groups, but also for the public in general. They offer to take on responsibilities towards citizens, which would otherwise have to be borne by the state. They also offer services in areas where it is not profitable for private companies to operate. The nonprofit sector is therefore able to offer services that are not provided by either the private or the state sector.

### *The innovative function*

NPOs often make experiments and take big risks connected with implementing unknown procedures. They serve as an incubator of new ideas. By identifying and efforts to solve still unnamed problems, they form new ways of solutions and work as pioneers in certain branches. They bring in innovations both into the service activities and to participating activities of citizens.

### *The advocacy or social change function*

NPOs are expected to protect their members and people facing the strong state-apparatus, private organizations, majority groups and individual peace-breakers of valid directive order. NPOs also act as a mechanism for gathering people and passing social changes, which are in their common interest, respectively in the broader public interest. They act as a mediator between individual citizens and the world of "high politics".

### *The expressive and leadership development function*

NPOs offer self-expression of their members and followers, both in the individual and the group sense of the word. They express religious, ethnic cultural, ideological, professional and other interests. People learn how to understand these interests within the frames of the organizations, how to develop a represent them. NPOs are "a school of democracy" and leadership.

*The community-building and democratizing function*

NPOs support plurality of opinions, interests and traditions. They also strengthen feelings of solidarity and community in people. They help people to create their own “social capital” support processes of bilateral interactions, support creation of credibility and reciprocity on which the functioning of market and democracy is based. NPOs move people to participate on public politics.

**Public and Mutual benefit NPOs**

NPOs can be divided by whether their activities pursue especially public benefit or that of its members. The first ones are called public benefit organizations (PBOs), and the others mutual benefit organizations (MBOs). PBOs provide services, which are in general interest and available to all asking for them. MBOs orient themselves to providing services to a relatively closed group of people, when the condition for using these services is the membership of the organization concerned.

**Service and Advocacy NPOs**

Another way of internally classifying NPOs is their discrimination to service and advocacy. As their names are telling, the first ones centre their attention especially to providing services of different kind, enter competitive relationship with commercial or state organizations providing similar services and aiming to succeed thanks to higher efficiency and quality of the services offered. The other ones focus largely on defending rights and interests of different groups of people (or public interests), trying to influence the decisions of the state administration and to support their requirements often mobilize the general public.

In terms of the interest pursued and general line of NPOs the nonprofit sector can be divided into four typical circles:

<b>General line</b>	<b>general</b>	<b>group</b>
<b>service</b>	Service PBOs	Service MBOs
<b>advocacy</b>	Advocacy PBOs	Advocacy MBOs

Obviously, thus acquired circles of NPOs are the ideal types not occurred in practice in its crystal pure form. On the other hand, these types significantly help us identify the cause of origin and role of NPOs in society.

## **NPOs and civic hopelessness**

Part of the heritage of the socialist mentality is present in the pertinent dichotomy “we down here” and “they up there”. Today’s stereotypes regarding politics, politicians, and democracy are not much different from those from the pre-1989 period. In a simplified way, one can say that most residents of CEE countries do not view politics as a service delivered in the name of the public weal, but rather as the seeking of the egotistical interests of amoral power holders, which escaped from the control of the people. A prevailing attitude is a combination of civic hopelessness and rejection of politics in general.

In such a situation, it is particularly important to create an environment in which such a dichotomy can be eliminated. Citizens involved in NPOs usually do not belong to those groups of the “hopeless” and “helpless” people. Even though they do not necessarily trust “big politics”, they are learning, for example, through cooperation with state or public institutions, to live in the world of politics, to communicate with it, to present demands to it, and finally, to come up with their own offers, guaranteed with their personal participation.

A particular contribution to overcoming civic hopelessness is made by human rights NPOs. On the one hand, they address people determined to defend the democratic rules of the game with the scope of their activities while, on the other hand, they also help “produce” such people. They contribute to the reproduction of community or some “permanently sustainable civil democratic culture” capable of resisting attempts to restore an authoritarian regime. Such an environment is prepared for a long-term struggle for democracy.

### *NPOs and the strengthening of social trust*

As shown in recent surveys, CEE countries are characterized by an increased level of the distrust of people in impersonal, “contractual” or institutional bonds. A certain stereotype has been observed here, according to which a citizen must be careful in dealing with other people: one can only trust relatives or close, personal friends.

NPOs form a bridge between strictly anonymous institutions, governed by strictly contractual relations, and the strictly personal world, consisting of family and friends. Frequently, NPOs are perceived as non-anonymous and personal; however, they also function as institutions. Their functioning includes many features of a civic involvement, togetherness, and trust. Therefore, the existence and development of NPOs can contribute to increasing the overall level of the trust of people in society.

## **Government Policies Towards the Nonprofit Sector**

### *Government and Nonprofit Sector Relations*

The relationships between the state and nonprofit sector can be in principle either cooperative or conflict. The cooperative models come out of the premises of inter-

dependency theory according to which the state as well as NPOs recognize that the method of mutual compensating for drawbacks is more effective than conflict. There can be two scenarios of cooperative relationships functioning:

*Cooperative scenarios*

NPOs monitor problem field of society, identify the problems they consider serious and mobilize the pressure on the state (government) to start taking interest in the problems. The state reacts positively, making out (and NPOs would help here) programs how to solve the problems, finding our resources for their materialization and then also turning to NPOs and commercial organizations to provide the respective services.

When the state does not react to the pressure to solve the problems identified, NPOs try to do so on their own. The state in time realizes (on its own, or, under the pressure of the public) that solving the problems identified is in public interest, appreciates the efforts made by NPOs, and tries to use their know-how they gained and starts to a certain extent contribute to solving the respective problems.

We can say that the cooperative relationships between the state and nonprofit sector prevail (except the time of Mečiar government in Slovakia). This is shown in the table below giving an overview of the financial resources of nonprofit sector in the individual CEE countries. The table shows the state is taking a significant part in funding NPOs in all countries, which can be seen as the proof of cooperative relationships between the public and nonprofit sector in these countries.

**Table 7-1**

Resources of monetary incomes of nonprofit organizations in some CEE countries (according the methodology Johns Hopkins University Comparative Project)

(Data for 1995, in %)	Incomes from donations	Incomes from the state	Incomes from the activity
Czech Republic	14	39	47
Hungary	18	27	55
Slovakia	23	22	55

Source: *Global Civil Society, 1999, pp. 25.*

But the relationships between the state and nonprofit sector in the countries are far from totally idyllic and conflict free. The major problem in this respect is the existence of state nonprofit sector (budgetary and contributory organizations), which are in a competitive position to NPOs. The public policies in the areas, where the state nonprofit sector and NPOs work parallel must continuously solve the

problem which to prefer – protection of state organizations, or enforcing market relationships in the area of services.

*Conflict scenarios*

NPOs come with new problems, suggestions and methods of their solutions. The state, however, would not accept them as legitimate, ignoring new methods and continuing in massive support to its own budgetary and contributory organizations, which, nonetheless, in time at least partially adapt to new trends and often take over the suggestions and methodology of NPOs. NPOs rebel against it and point at low effectiveness of state organizations, their fossilized nature and resulting inability to fully use new methods and procedures.

The outcome is inconsistency of public policy. The cooperative scenarios typically have no support in legislation and therefore cooperation very often depend only on open-mindedness and liberal outlook of individual officials and their good, informal relationships with the representatives of NPOs. Moreover, the public policy towards NPOs is formed by actions of more institutions (government, president, ministries, parliament, regional bodies of state administration, local government), and their approaches are considerably different). As the Hungarian author Eva Kuti writes:” In most Eastern European countries, there are several explicit and implicit government policies influencing NPOs and they often lack consistency.... public policy toward nonprofits is a complicated set of particular and more or less contradictory policies developed by different legislative and government bodies.” (Kuti, 1999, p. 52 – 3)

The governments of CEE countries have, so far, not created the necessary instruments for a selective policy towards NPOs (e. g., they do not distinguish between PBOs and MBOs and as a consequence would not give higher tax benefits to those acting in line with their public policy). Even though the political colour of the governments in the individual CEE countries has changed during the last decade, their general attitude to the nonprofit sector has not. Centralism is still dominant, as well as pushing NPOs out to the periphery of transformation processes. Centralism is manifest mainly in maintaining the central system of NPOs public funding and in keeping “the monopolistic position of the state in fields like social services, education and health care.” (Les, 1999) But by this line various anomalies are being conserved, the ones the communist regime left behind in the nonprofit sector. It is visible when comparing the internal structure of nonprofit sector in the CEE countries with that in the countries with developed democracy. Disproportions are found in the areas of social services, education and health care, which are in these countries markedly undersized, while the area of culture and recreation, which was under the communist regime supported out of ideological reasons, is markedly oversized.

Table 7- 2

Proportion of employment in the countries in the total employment of nonprofit sector in the Central Europe Countries, Western Europe and in other developed countries (USA, Japan, Australia and Israel)

N=1052, data for the year 1995, in %)	CE countries	Western Europe	Other Developed
<b>Other</b>	4	1	2
<b>Environmental and Advocacy</b>	6	3	2
<b>Community Development</b>	6	6	5
<b>Professional and Unions</b>	11	3	4
<b>Culture and Recreation</b>	35	10	8
<b>Social services</b>	12	27	15
<b>Health</b>	8	22	35
<b>Education</b>	18	28	29

Source: *Global Civil Society, 1999.*

Politicians, public administration, corporate sphere and general public only very slowly become used to the activities of NPOs and pay only little attention to the consolidation of the situation in the nonprofit sector. Whereas the commercial and public sector in the transformation years enjoyed much attention, care and generous financial assistance of all social actors, the nonprofit sector was not at all included in transformation thoughts and conceptions and its development was and is very much undercapitalised.

*“During the early stage of the political changes in Eastern European countries, voluntary citizens’ organizations were widely believed to have a role to play as a vehicle for political, economic and social reforms and to be an actor in the formation of civil society. Since then, however, such an understanding of the role of voluntary organizations in public life has become less popular among political elites in some of the countries in question. In Poland, for example, after several years of political, economic and social changes, the idea of civil society has clearly lost its appeal for the political elites and therefore, lost their support.” (Les, 1994, p. 16)*

The same could be said about the Czech Republic and Hungary. Today we cannot say the representatives of nonprofit sector in the CEE countries would agree on which of the partnership models is best for their country. The success of their efforts to build their own, coordination bodies is different in each country. It seems that in Slovakia they are most advanced in this direction, with the “Committee of

the third sector” having built a respected position towards the government and parliament. It is a paradox that it was the state alone helping it, as the state in its conflict policy managed to unite NPOs in their action towards the state. In the other CEE countries NPOs make an impression of inconsistency in spite of integration processes going on at different levels (local, regional, national) and in the areas of nonprofit sector; but the fear of oligarchization and from the times of communism inherited suspicions of umbrella activities are still prevalent here.

### *Old and New NPOs*

One of the key factors hindering the process of building common coordination structures is the fact that the nonprofit sector in the CEE countries is split into the so-called old and new NPOs. (Frič, 1998, Kuti 1999) The **old NPOs** (e. g., sports clubs, firemen, hunting clubs, or those of gardeners, breeders, bees keepers. . .) functioning under the government of communists had built routine relationships with the government and state bodies and tackled routine problems, and doing so usually did not go against the rules of government and ministries. Even the old advocacy organizations, such as e. g., trade unions and professional organizations managed to very swiftly formalize their relationship with the new government and institutionalize the solution of debatable situations. **The new NPOs** (founded after the year 1989) had to only build their relationships with the state administration and by naming new problems, criticising existing lines taken on social problems and not traditional methods of their solutions, disturbed the routine of administrative bodies. Their negotiating position to the state has been improved in time, also thanks to their international contacts in “the West”, but they perhaps too often face the wall of conservatism of state officials more likely to prefer the certainty offered by the old NPOs.

The new NPOs accuse the old one of benefiting from favoritism when resources are distributed by the state and of fostering paternalistic relationships within the non-profit sector. In making such accusations they are, of course, calling into question the civic status of those NPOs, because organizations that do not respect the basic principles of the way society functions compromise the non-profit sector and have no place within it.

The inclusion of most of the old NPOs within the non-profit sector (sports clubs, horticultural and breeders associations, volunteer firemen and hunting associations) causes unease among the representatives of the new NPO's. They often talk about the non-profit sector as if the old NPOs did not even exist. The new NPOs often look down on the old NPOs with a feeling of superiority stemming from the fact that, unlike the old organizations, they were never “in bed with” the Communist regime. It is not too much of an exaggeration to say that there is a “cold war” between the old and the new NPOs over resources and influence within the sector. The old NPOs make no public comment on the current situation, distance themselves from their Communist era identity and do not even attempt to represent the non-profit sector to the public. They concentrate instead on lobbying the state administration,

parliament and government. They act autonomously and within certain fields they are well integrated vertically and have no need to establish coalitions between different branches (for example churches or trade unions).

### **Alternate Visions and the NPO Infrastructure**

The nonprofit sector is an inseparable part of the ongoing processes of transformation, not only because of its economic importance and the services it provides, but also because of the contribution it makes to the creation of a civic society. Its role should, therefore, not be seen as a convenient way for the state to relieve itself of the burden of part of the costs of providing the services the public expects from it. That vision of the role of the nonprofit sector may well be legitimate, but it is certainly not adequate. There are two main reasons why:

The first reason is that such a view is, in our current situation, an oversimplification, because it reduces the role of the nonprofit sector to some sort of "service appendix" to the state – in other words, something extra, over and above the services provided by the state. Or, alternatively, the nonprofit sector is seen as an emergency service, going into action when the state is momentarily unable to cope with a problem. To prevent the vision of the nonprofit sector as an entity whose mission is to solve the problems of the welfare state sliding into the role of a mere provider of services to relieve the pressure on state institutions, we must combine it with **the vision of an autonomous partner**, which, because of its approaches and methods of service provision presents a legitimate alternative to state organizations. In practice this means that the state should not be afraid to expose its own state-maintained service providers to competition from NPO's.

The second reason why the vision of the nonprofit sector as something that merely solves the problems of the welfare state is inadequate, is because it ignores the democratizing and non-partisan dimension of its role in society. Creating a civic society, getting citizens interested in public affairs, supporting a democratic political climate, influencing public policies, creating a "buffer zone" between the citizen and the state, are all functions which the nonprofit sector should fulfil. They are functions that go beyond the purely service role allotted to the sector by the state and a section of the public as the only appropriate and acceptable role for it. That is why our concept of the direction in which the nonprofit sector is to develop must be supplemented by **a vision of the nonprofit sector as a social actor** active at all levels and able to represent the genuine interests of the citizens and, through its activities, to guarantee the democratic development and stability of the country. It is a vision of an organizational network which is involved in non-partisan politics, stabilises civic relations, enables and stimulates informal citizens' initiatives and gives citizens the opportunity to participate in public affairs irrespective of political or government crises. It is a vision of a "safety net" in civic life, analogous, to some extent, with the safety net of the welfare state (Čepelka, 1999). It is also a vision of the nonprofit sector as an active force in decision-making processes, linked to international structures, able to mobilise the public,



### *Nonprofit Infrastructure*

The ability of nonprofit sector to act as a social actor and partner of the state much depends on its internal qualities as a whole, i.e., on the character and density of its internal networks inter-connecting individual NPOs. In essence, we can identify the following nine internal networks making the infrastructure of nonprofit sector.

- 1. Conception network** is made by organizations (e.g., academic workplaces, chairs of philanthropy), temporary ad hoc task teams, informal think tanks and individuals involved with the issue of civil society, conceptual questions of nonprofit sector as a whole and of its individual parts. This network collects reliable, trustworthy findings about the parameters of the sector, examine and produce ideas of its role, or, that of its individual parts in society. Its role is to provide a forum for confrontation of ideas and opinions, to develop concepts for solving partial problems, build the ideas fund of civil society and ensure the flexible response of the sector to suddenly emerging issues.
- 2. Coordination network** - its bearers are different associations of NPOs, umbrella organizations, platforms, regional and field groups of NPOs, local coalitions, etc. Its purpose is to integrate NPOs, make the other network communicate with each other and coordinate meeting the goals inline with the products of the conception network, to strengthen the importance of nonprofit sector in civil society and ensure the participation of NPOs in the processes of forming the public policy, reach the desirable level of consensus in the nonprofit sector, identify the common issues and interest and mobilize the nonprofit sector and the general public in their defence.
- 3. Facilitation network** - its purpose is to support contacts (networking) and encourage cooperation between NPOs as such and between them and the state administration or commercial sphere, take care of this cooperation and make the climate of trust among (potentially) cooperating subjects. This network is composed of facilitation centers and individual professional facilitators aiming to handle the problems of building coordination networks, mutual rivalry of NPOs and lack of their inter-communication.
- 4. Advocacy network** - through its advocacy centers providing NPOs the professional lobbying and advocacy service in the form of monitoring legislative processes, developing right contacts, preparing written documentary and materials, maintaining communication channels, delivering information (training) about the techniques of lobbying and performing legal advisory in the respective area. The general meaning of the advocacy network is to assist to desirable changes proposed and negotiated in the conception and coordination networks of the sector.
- 5. Evaluation network** - comprises accreditation committees, advisory groups by the bodies of the state administration and assistance and monitoring centers. The meaning of the valuation network of nonprofit sector is to generate and test the standards of services provided by NPOs, differentiate NPOs by the quality of their service products and assess the practical implementation of the projects funded.
- 6. Information network** of nonprofit sector is not only the matter of technical equipment of NPOs. This network comprises various information centers (central, regional, branch, etc.) and databases of NPOs. The aim of the functioning information network is to widely disseminate the desired information (e.g., also for research purposes), to offer opportunities to communicate for those interested in them, to mediate contacts, provide the room for building mutual trust, motivate NPOs to break the barrier of isolation and open for them chances to get involved in common events having a great effect on forming the common collective identity.
- 7. Educational network** - its purpose is to create conditions for making NPOs employees and volunteers professionalized, to spread and strengthen their collective identity as members of one - nonprofit - sector in society, to make a strong group of "as a citizen educated" university graduates who in their workplaces will continue spreading the ideas of civil society and the role of nonprofit sector in society. Its structure constitutes various education, training centers (for training/coaching of executives/managers, professionals, specialists and coaches), advisory organizations and academic workplaces.
- 8. PR (public enlightenment) network** is primarily bound to everyday activity of individual NPOs, but its important part is also specialized NPOs focused on the area of PR activities. The meaning of this network is to manage - at the professional level - solving the problems in the area of relationships between NPOs and the public, bodies of the state administration and commercial sector. The core activity of service nonprofit PR organizations is primarily to run campaigns, mediate feedbacks to PR activities of NPOs, training in the area of PR, building contacts in business, state and autonomy structures, cooperation with the media, enforcing and advertising the teaching of the subjects from the area of civil society and nonprofit sector in primary and secondary/high schools, etc.
- 9. Self-regulatory network** - centers its activity on producing, disseminating and checking the adherence to the desired informal norms of behavior. One of the key roles in this process is played by member associations of NPOs, umbrella organizations but also informal groups of NPOs making the right platform for discussing ethical problems, formulating ethical codes of conduct for their members, disseminating the awareness of the necessity to write annual reports, cultivating and fulfilling the role of boards. In this way the climate of transparent NPOs activities is supported, and through informal (social) checks on following the shared rules of the game the pressure put on the behaviour of individuals and entire organizations. In other words, the self-regulatory network supports the positive and holds back the negative examples of the behaviour of NPOs and its members or employees and at the same time strengthen the legitimate position of nonprofit sector in society.

to put pressure on other elements of society and act as a partner to the public and commercial sectors. In other words, it is a vision of the nonprofit sector not as a mere appendage to the public and commercial sectors, but as an alternative and counterbalance to them.

There is no doubt that after the long time of non-development, the nonprofit sector needs to consolidate its position in society. There is also no doubt about “the lack of political will” causing a serious delay in the nonprofit sector consolidation. The question is how to do it to find enough of political will to solve the problems of nonprofit sector. It would certainly be naive to expect that political parties would recognize on their own the importance of the need to consolidate the nonprofit sector in CEE countries. The only way how to do it is to try, using the inner strength, to overcome the “crisis of identity” of nonprofit sector and materialize the vision of its changeover into the social actor able to defend their own interests. It means that the nonprofit sector must be able to conceptually prepare, organize, facilitate, coordinate and moderate the changes inside its own self. At the same time it will be necessary to reconcile the efforts of many individual NPOs, their branch or regional groups, coalitions, associations or umbrella organizations so that they would work in synergy. To act as the social actor means formulating and defending own interests through joint activities of a bigger number of NPOs. Without that the identity of the nonprofit sector remains inconsistent and the sector as a whole is not able to act as the partner not only at the central social level, i. e., mainly towards the government, ministries and parliament, but also at the regional and local level.

### **Conclusion**

According to Salamon and Anheier there exist in principle three functioning models of partnership between state and NPOs. They called the first one “the German corporative model”, where several associations of NPOs formed a formal, cooperative body the government is obliged to consult with the questions in all main social areas. The second is called “the American model of interest groups”, which through lobbying gives individual NPOs major possibilities to influence the results of legislative process, but always, only in an ad hoc formally non-codified method. The third one could be called “the model of program cooperation” and works in Great Britain. (Salamon – Anheier 1994, 104) We could say that old NPOs tend to prefer the corporative model, and new NPOs so far cannot agree whether the model of interest groups is better for the nonprofit sector, or that of program cooperation (which requires forming a joint, umbrella organization negotiating the goals and conditions of meeting the program by the state).

It is obvious that NPO representatives prefer the cooperative model of public policy influence, a model that does not have strictly set rules, suffers from clientelism and lacks opportunities to enter the decision-making process. Until now there have been no significant NPO efforts to change this model. NPOs representatives have not even been able to clearly articulate which model of partnership

with public institutions is suitable for them and which one they would like. With a few exceptions, the current situation favors those politicians and civil servants that like to see the NPOs in operation, but tame and weak. It is a strategy that maintains the asymmetric relation between public agencies and NPOs with the help of insignificant appeasement policies, such as the willingness to communicate and cooperate in order to find solutions where a synergy of goals already exists. NPOs representatives appreciate even this small development within the bureaucracy – they are no longer considered to be eccentrics with no value and importance in society.

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# Chapter 8





# **Ethics and Public Policymaking: An Incomplete Transition in Central and Eastern Europe**

*Brack Brown*

## **Introduction**

This chapter deals with applied ethics in policy making with commentary on and examples from Central and Eastern Europe (CEE) and the United States. Gulyás and Potucek establish a useful philosophical and ideological context for this material in their earlier chapters in this volume. I start with the premise that there are many kinds of “values” which are considered by different participants in the public policy process, whether the formation of policy follows from formal methods like many described throughout this volume, or whether the policies are produced in very *ad hoc* and unsystematic ways. The particular set of values in focus here is “ethics.” The role of ethical values in how states, governments, and officials form and carry out policies has been a subject of continuous concern to Western social scientists, humanists, and public figures. Unfortunately, the subject has been almost totally neglected for decades in Central and Eastern Europe because of the paramount importance that Marxism attached to disparaging Western value systems and principles derived from studies over past 2500 years. For a healthy and relevant discourse on ethics to be restored and applied to public affairs in areas long under Soviet control, a very self-conscious effort to do so must be undertaken in all sectors including the governmental, business, non-profit, and intellectual sectors. As I will try to demonstrate, this project is vital for the establishment of sound footings for democratic regimes, modern market economies, and healthy civic cultures.

Some readers might be inclined to dismiss any discussion of ethics as simply deliberating about a failed myth. Those who lump ethics together with scepticism about all ideology, religion, politics, and even law are in effect saying that there are no reasoned standards for producing good policies, good governments, or good societies. They implicitly argue that we can’t choose to deliberately create or foster the morally desirable qualities of peace, order, decency, and happiness. They fail to recognize that the will to cooperate and to improve the human condition is always in tension with the more selfish impulses of man. But only where people have been willing to engage optimistically in the struggle between unchecked impulses and socially beneficial impulses have some broad measures of peace, order, decency, and happiness been won for majorities in modern societies. Where the space for such a struggle has not been created, these precious social and moral goods do not materialize.

The possession of ethics, like the possession of property, does not bear fruit except as the result of cultivation and hard work. As we will see below, the essence of ethics depends upon reasoned choice, respect, good will, and considerations of consequences for others. Though we are all capable of acting on these premises, we

are also capable of narrowing these premises so that they only apply to our own group, to some particular interest, or only to ourselves rather than applying to the wider social world in which we live. In their narrowest form, ethics degenerate into despotism, nationalism, nepotism, tribalism, cronyism, and egoism, all of which view human benefit, duties, or the consequences of our actions as applying to a selected few. If entitlement to ethical treatment is drawn narrowly, it is likely to contribute to oppression, conflict, alienation, and misery. People will not have a fair chance or the incentive to compete for political and economic benefits. It will make it only harder to establish ethical standards in the bureaucratic, political, and intellectual spheres. No society reaches ethical perfection, but ethical principles can be learned and practice can be strengthened. This chapter is written in the hope that it will help those engaged in policy work to recognize and strengthen the ethical components in their work of designing and implementing public policy.

Ethical questions about policy deal with such questions as how should virtuous people behave in the policy process? What good or bad intentions are reflected in the policy decisions themselves, or in the process and structures of policy implementation? How fairly (or not) are the harms and benefits distributed in the actual outcomes of policy? In discussing these questions throughout the chapter I try to take into account the special circumstances of transition that pose limits on and opportunities for ethical policy making in CEE countries. Regarding the way ethics is treated here, the reader should know that there is a distinction between the concern of social scientist's with 'knowledge about' public policy ethics (i. e., what are the important questions to ask), and the concerns of policy actors about 'knowledge in' (i. e., what are the things that should and can be done). Sound ethical judgements must take both into account.

Some important concepts about ethics in government and public policy are introduced based upon a large and growing literature on this subject in the United States. The overall relationship of ethics to the operation of democracy, law, civic life, and market economy will be discussed. A few frameworks are identified which can be used in evaluating different ethical dimensions of policy making either by those interested in studying public policy from an ethical point of view or by those who are responsible for developing, deciding on, implementing, and evaluating public policy. An assumption guiding this development is Wildavsky's assertion in his book, *Speaking Truth to Power: The Art and Craft of Policy Analysis*, that "moral considerations are integral to the enterprise and that high standards protect against the demonic (p. 14)."

### **Ethics Problems in Central and Eastern Europe**

In Central and Eastern Europe (CEE) the very word "ethics" provokes a strong reaction. For such a "good" thing it has a bad name. This is so for a variety of reasons. One of them is that Central Europeans have had a long grim exposure to powerful ideological, political, and religious excesses by various true believers in the absolute morality of their church, empire, or party. But insistence on the

sanctity of empire, or class, or Marxist doctrine is not properly ethics as it is being considered here. The second reason is that the recently imposed communist belief system created a hangover that propagated habits that still persist today, particularly in public life. Such habits have massively discouraged honesty and individual integrity. A third reason ethics has a bad name is that many people in the region are not familiar with the necessary moral requirements for establishing successful democratic systems. Unfamiliarity is exacerbated by the preoccupation of too many public and business leaders with purely economic concerns – wealth and material success. It has resulted in the kind of cynicism clearly outlined in one of President Havel’s annual addresses to the Parliament, in which he noted:

*Many believe that – democracy or no democracy – power is again in the hands of untrustworthy figures whose primary concern is their personal advancement instead of the interests of the people. Many are convinced that honest business people fare badly while fraudulent nouveaux riches get the green light. The prevalent opinion is that it pays off in this country to lie and to steal: that many politicians and civil servants are corruptible; that political parties – though they declare honest intentions in lofty words – are covertly manipulated by suspicious financial groupings. (State of the State Speech to Parliament, Dec. 1997, P. 1)*

Havel rightly suggested that the building up of civil society, moral attitudes, and transparency in government should be considered more than a “seasoning”. It should be the foundation. It is a misfortune for the region that very often such legitimate calls to a higher standard in politics, public administration, law, and business life are routinely ridiculed as being only sugar to disguise another bitter pill.

A Czech speaker, very familiar with both Czech and US policy systems recently addressed my American graduate student class on the “Ethical Dimensions of Public Service.” He puckishly began his talk with the remark, “You may be surprised to hear me say that in my country we do not have any ethics.” His intentions were to underline the phenomenon that a Czech politician once labelled “Wild West capitalism,” and to comment on the kinds of problems confronted during the early stages of transitioning to democratic practices and free markets. In the transition phase, it is especially difficult to know where ethical boundaries lie and so they are frequently violated as they were in the lawless, free-wheeling American “Wild West.”

Throughout Central and Eastern Europe it is common for ordinary citizens as well as top leaders to express cynicism about someone’s claim to have good intentions. And why should it be otherwise given two generations of systematic (official) lies, misconduct, and governmental interference with the autonomy of every individual and organization. Ethical practice, (for the moment defined as possessing good intentions and performing morally good actions), in such an environment appeared to be only possible in primary relationships between people – family, neighbours, and workmates. But even at this level it was subjected

to distorting influences, so mentioning ethics and policy in the same breath was often considered hypocritical.

Even today the idea that ethics governs or restrains the behavior and decisions of policy makers is considered highly unlikely by many citizens. The orientation planted by the previous regime persists. There is deep cynicism about the intentions of most state officials and a widespread belief that policy making is divorced from ethical considerations. Though official communist control dissolved, it is widely perceived that the new freedoms have only unleashed a torrent of self-interested market manipulations and political corruption and that ethics will always take second place.

It is unfortunate that raising ethical issues about the values of honesty, integrity, truth or the public good marks one as “naïve”, if not stupid, especially if it is done in the context of government, public policy, politics, or the State. But why have cynicism and distrust remained so deeply embedded in the CEE countries more than a decade after the fall of communism? I have already argued that those who lived through communism were systematically and thoroughly de-moralized. Some analysts believe that unceasing State (or party) control on the one hand and perfecting the arts of trickery, deviousness, and the creative lie by citizens, on the other, seriously undermined the sense of civic duty, or the capacity to accept responsibility for one’s own acts by citizens and their leaders. Official injustices and control of choice assured this. The point is well made in a review of Slavenka Drakulic’s book, *Cafe Europa: Life After Communism*:

*... some of the tendencies created or exacerbated by communism include: hypocrisy and prevarication as survivalist techniques, an inability to believe in a better future [encouraging people to take whatever they can today by any means necessary], a . . . fear of taking risky stances, a deep-seated need to blame failure on any possible Other, and a dangerous eagerness to erase, rather than admit or inquire into, past mistakes (In Ashley, 1997: B – 4).”*

These themes have also been explored in unusual detail in Timothy Garton Ash’s recent book, *The File*, which looks at the effects that secret police informers had on people’s lives as well as the effects it had on the lives of the informers themselves in former East Germany (Ash, 1997). Some observers expect that more than a generation must pass before a new set of attitudes develops.

Communist states actively and systematically taught that capitalism was morally bankrupt and Western democracy was a sham. The worst instances of Western selfishness and exploitation were regularly presented. It planted in the people’s minds a mistrust of most organizations, institutions, politics, and even the law. Citizenship was robbed of meaning. Only in the small sphere of family life, did it seem that a person could apply standards of right and wrong, loyalty, compas-

sion, fairness, and justice. But even at this level, human relationships were still often exploited.

People's views of post-communist ethics have unfortunately been reinforced by many instances of real corruption. Widespread mafia type activity throughout the private sector in the region and the success of former nomenklatura and secret police as capitalists and officials are facts of life. Self-promoting, inexperienced, amateur legislators who fail to disclose the sources of their support and who sit on important boards of private companies convince many voters that conflict of interest and secret deals are the norm. The fall of the Klaus government in the Czech Republic in November 1997 was directly attributed to this cause. Scandals surrounding telecom and media companies added to the climate of suspicion. All the countries in the region experienced humiliating exposes about officials who obtained or retained high administrative posts because of old connections. Many citizens see them as self-interested careerists, holding on until pension time and obstructing every proposal for desirable change. Deliberate delay and unnecessary secrecy, are still common. Initiative, enthusiasm, pride in work, and concern about "the public interest," are not so common. The only exceptions, in this view, are a very few highly motivated, reform-minded officials, who tend to be enormously overloaded, but who try to do the right thing despite the poor odds. Thus, ordinary citizens often feel cheated of the fruits of change.

A great many policy initiatives in CEE countries have been adopted to demonstrate the worthiness of each country (some say entitlement) to "reenter" the West. The assumption was that certain policies would make them look like acceptable member or partners of the European Community and/or NATO. But the ultimate success of these policies rests upon many intangibles such as the observance of human rights standards and the rule of law and having domestic policies that are socially just, that keep the government's word concerning acceptance of the rules of these international associations, and that presume a competent, service-oriented public administration. One of these "intangibles" is trust. It is an important component of ethics.

According to Frances Fukuyama, "trust" is one of the indispensable qualities necessary for success in forming and running large scale economic and political organization and securing both domestic and international cooperation (Fukuyama, 1996, p. 151). These commitments work best when basic forms of political democracy exist, but especially when all parties observe ethical standards such as playing fair, keeping promises, and behaving justly. Mary Kaldor also extensively examines this question in her *Democratization in Central and Eastern Europe* where she discusses the role of ethics in a democratic political culture (1998). But how is it possible to expect adherence to higher ethical standards if the negative attitudes outlined earlier are a commonplace reality? Some of the possible answers to this question will be looked at throughout this chapter, but first I will examine how the capacity of states, governments, and policies to produce democratic outcomes rely on clear ethical thinking.

### **The Ethical Foundations of Public and Private Institutions**

The past decade of transition activities has shown that the new structures and procedures of democracy and markets are fragile and can easily be abused. Corruption of newly established instruments of democracy, government, state, and policymaking can easily happen in the absence of substantial and intentional efforts to protect and strengthen them. Several conditions are necessary for these institutions to become as strong as their Western counterparts. The simple act of formally creating new structures and procedures does not mean they are fully capable at birth – they are still relatively weak and incomplete for many years. Many underlying values and intermediate institutions (professional societies, civic organizations, etc.), need to be cultivated if these instruments are to properly mature.

Rady observes that CEE states have problems accepting the idea of working with or appreciating ethical suggestions and criticism from intermediate institutions when, as he notes, those institutions are themselves underdeveloped. Rady says, "in the states that have them, intermediate institutions can be used to mediate between government and the people. These non-state institutions enjoy popular confidence and are vested in authority deriving from notions of contract and consent (In Duncan and Rady, eds. 1993)." Weak intermediate institutions leave states top heavy and weak because not all sources of legitimate policy proposals and criticisms are available to them. In fact state officials and politicians often view local and regional governments, NGOs, professional, trade, and labour associations as irresponsible and radical rather than as collaborative and complementary. Thus, for CEE states to acquire the capacity to become mature democratic, market, and civil societies there must be a concomitant strengthening of ethics standards and of the institutions that espouse them. Ethics must be made part of the political regime values, part of the bureaucratic procedures, part of the civic culture, part of professional codes, and part of the market culture.

The importance of developing these ethical foundations was emphasized in a Statement by Czech President, Vaclav Havel reported in 1997: "President Havel has said that no legislation can be effective if society is not built on ethical foundations. Speaking during a meeting with the Swiss Justice minister Mr. Havel pointed out that although democratic institutions are now established in the Czech Republic, they often lack the necessary democratic content and spirit (Radio Prague E-news, October 23, 1997)." Pavel Campeanu also makes an interesting argument about the interdependence between the development of public policies and of the development of the ethics that should underlie them. In an article entitled "Between Democracy and Democratization (October 1993, p. 3), he argues that if there is a strong ethical climate in a country it will encourage the expression of important civic and political values like trust, participation, loyalty, and confidence. But, he notes, such climates in turn evolve from the way policies are formed, decided, and implemented. Where this reciprocal relationship is found one also finds democracies.

## Dependence on Embedded Ethics

More will be said below about ways of strengthening the ethical base in transitional societies, but first it will be noted here that another factor plays a large role in how the new institutions and practices in CEE states get their ethical legitimacy. It is fortunate that some component of ethics are “built into” or embedded in the institutions and instruments of democracy (and even in many liberal capitalist institutions). After all, a serious decision to introduce democratic and constitutional structures presumes a certain minimum acceptance of a claim to human equality, dignity, and choice. Thus some ethical assumptions are deliberately embedded, planted, and reflected in the matrix of rules, processes, and structures at the time they are originally established or reformed. In other words, democratic structures, processes, and laws of democratic states are created to some extent with at least the implicit purpose of institutionalising ethical principles. Equal justice, representation, open debate, trial by jury, checks and balances, merit civil service systems – without these, neither state nor economic nor civil sectors can operate fairly, reliably, predictably, or peacefully. But they must also be honestly enforced and not cynically exploited.

These presumptive or embedded ethics will then be found wherever the common standards have been set up *with the good intention* and with the assumption that all parties *ought* to be equally bound by them. This is true whether we are speaking about a country’s weights and measures, the value of their currency, a constitution, a law, a license, or an educational degree. The public can presume that the standard is fair, the practitioners are competent, and that they will not be cheated. On the other hand legal statements and mechanisms for their application can never be enforced perfectly, so it is also necessary that the relevant values, like honesty, be internalized – become part of the ethos of bureaucrats, policy makers, and citizens.

Embedded ethics may also be found in the economic sector, for instance in the form of financial and accounting standards, disclosure requirements, stock trading rules, and business contracts. They are normally *intended* to assure a recognized and standardized base of socially responsible behavior, actions, and policy. In this, large roles are also played by the state (e. g. in education), by economic actors (e. g. in devising professional codes), and by various social institutions (e. g. Boy Scout organizations). Family and religion of course provide some ethical teaching but not enough to navigate in the more complex organizational and institutional arenas.

Finally, embedded or implicit ethics can also be seen to operate in public policy analysis, which will be discussed in more detail below. In America, professional policy analysts often assume that taking a scientific, neutral, objective, and quantitative approach to public policy questions, (e. g. using statistically valid surveys, samples of public opinion or, cost-benefit analysis, etc.) will assure that the decision processes will produce fairer judgements? This is partly true. Some right things can be done and wrong things avoided by this “scientific” analysis but not because science alone is adequate and ethics are superfluous. Rather, it is



because ethics are already part of previous policies, mandatory codes, and guiding constitutional and legal decisions. In this way some ethics do get considered without formal analysis.

### **Ethics Morals, and Other Values: Ethics**

In its formal meaning ethics is a branch of philosophy devoted to the systematic analysis and understanding of moral problems and what constitutes right and wrong (Frankenna, p. 3). Frankenna tells us that ethics is a social instrument for providing guidance in its methods of analysis for rationally examining our moral statements and how we ought to live (p. 5). Linking this to practical questions, he says, "The ultimate concern of the normative theory of obligation [ethics] is to guide us in making decisions and judgements about actions in particular situations (p. 11). For most people the everyday sense of ethics is that it is only about being a decent, honest person who can be trusted; about a person who is concerned with the well-being of others, and who does right things as a consequence. But ethics is also about standards that measure the extent to which we hold people accountable for their actions or inaction, the extent to which there is justice in the allocation of resources to meet basic human needs; and the extent to which we grant respectful treatment to all people. Ethical standards apply equally to our interpersonal, group, community, and political life. They provide us with criteria to determine whether our decisions and actions are right or wrong in regard to first, **what** we do, second, **how** we do it, third, **why** we do it, and fourth, **the results** of what is done. Ethics, therefore, is about much more than merely personal conduct.

Some of the specific concepts intrinsic to most ethical systems include justice, equity, fairness, truth, and regard for the basic needs of others (food, shelter, security, identity, individual autonomy and dignity). Ethics also encompasses the expression of empathy, compassion, mercy, generosity, integrity, responsibility (especially for harm caused to others), the common good, honor (or promise keeping), courage, honesty, and trustworthiness. These are considered common virtues by many cultures. Laws may be passed to support these virtues, but laws by their nature emphasize what should not be done lest it be punished, which is a negative approach. Ethics takes the positive and analytical approach of requiring the reason *why* something should (ought to) or ought not to be done. There can be bad or wrong laws (eg. slavery or suppression of speech, language or religion). Laws, therefore, are only sometimes a substitute for ethics. More about law and ethics will be discussed below.

To conduct an ethical analysis of a policy we not only need to know what is considered to be right, but also what is considered to be wrong. There are many familiar words that specify what are *unethical* behaviors or intentions. In listing them it is important to recognize, and it bears repeating, that they might or might not be "against the law." They include: malice, murder, greed, selfishness, lying, coercion, torture, cheating, bribery, stealing, disloyalty, deceitfulness, dishonesty, disrespect, and oppression. In a Christian religious vocabulary these would be



called sins. Even in the field of politics we refer to sins of commission (knowingly doing wrong) and sins of omission, (not acting for the right or not avoiding wrong even when you know what it is). Ethical analysis is difficult because there are exceptional situations where even doing wrong might be necessary, (though not good), such as in a wartime situation. An example of this was when Winston Churchill during WWII said he would even make a pact with the devil to defeat Hitler. The violation or compromise of an ethical principle to presumably serve a higher or longer term nonethical good, however, is controversial and justified only in special circumstances (Willbern, p. 107).

Another useful thing to know about ethics is that there are different 'levels' of ethics. According to Kohlberg and many other writers, there are levels and types of ethical thinking that normally develop as we mature. Maturation is partly about the increasing ability we acquire to provide reasoned arguments (to ourselves and others) about what is right, and especially why it is right. Kohlberg explains how the reasons we give for behaving well or making good decisions change as we learn to be more ethical. In childhood these reasons for being good include avoiding punishment, getting approval, or getting advantages from voluntarily obeying the rules. The fully mature level of ethics is reached, according to Kohlberg, when our ethics are based on a willingness to act on what is right when rationally examined, in other words, knowing why something is right or just. If the ethical person then fails to act on these reasoned conclusions it results in self-condemnation, remorse, and an urge to restore the good. This is what we call having a conscience and "being just" (Kohlberg, 1968, and Kohlberg, 1981). In public policy the need for actors to consult their conscience is not, therefore, as vague as it sounds. Employing conscience in policy making is a call for ethical analysis, not just voicing opinions. This may all become clearer after the discussion of the nature of "morals" below.

### **Obstacles to Ethics – Relativism and Indifference**

Two major obstacles to establishing a serious dialogue about appropriate ethics in CEE transition conditions are widespread indifference and the simplistic appeal to relativism. Indifference in part comes from clinging to habits of mind made necessary for survival in communist times. Indifference is a position based on the belief that it doesn't matter whether ethical discussion and analysis takes place "if no one gets hurt," or if everything turns out all right. Politics doesn't matter because it is just a game played for the benefit of the few. Not getting caught is the trick. From this perspective ethics, like markets, operate, if at all, through an invisible hand, or luck or fate. Indifference is a lazy approach to ethics and dangerous to a democracy. Along with relativism, indifference puts a burden on embedded ethics and on explicit ethics.

Relativism is the most common, though fallacious, argument against the systematic application of ethics to political (or social) life. To the relativist one person's values are a good as another's. Relativists ask, who are we to judge what is right and wrong for someone else. In CEE countries this is especially surprising given the

near universal condemnation of communist practices. The essence of the relativist position is that it denies that any particular ethical conclusion can be superior to any other. Exaggerating its premises might help to make the point. Relativists say that if they believe that some minority should be excluded from an educational or welfare benefit, their “ethics” are as valid as another person’s belief that all citizens should have equal opportunities to all public services. There is according to relativists no way of proving that one set of prescription about what is right is superior to another, though they insist that others respect their position (which itself contradicts their claims since they assume a common understanding of what respect means). Relativists may also claim that each individual has his or her own “personal ethics.” While people may be free to make choices and have their own ‘convictions’, they cannot simply ignore the established ethical language and understandings which preceded them. This language identifies wrongs and rights that have been examined and recognized for hundreds of years. To say that *I ought or ought not* is to recognize that there are “oughts,” i. e., that “ought” has a meaning beyond the definition a single speaker wants to give it. We are not free to arbitrarily reorder these meanings to suit our preferences. R. M. Hare discusses such distinctions in more depth in his *Essays in Moral Theory* (1989, pp. 179 – 90).

It is the frequency with which these fallacious claims of relativism and personal ethics arise which often drives policy analysts to say that values are too controversial or ambiguous to use as a criteria for policy making. They are correct that many policy actors bring to the discussion highly questionable claims about what is right and wrong. They are not correct, however, in believing that it is impossible to rationally examine what is right and wrong and why. They fail to see that a simple assertion that something is moral does not make it ethical.

A related or perhaps third obstacle to ethics results from government leaders assuming that a democratic election mandate ratifies all their values as the ones that should guide policy and conduct of government – no further consultation is necessary. From a public policy perspective we need to recognize that once established, political regimes and legal orders need to continue to demonstrate their ethical virtues in every decision. Ethical values are even more basic than procedural democracy, though democracy is the political order most congenial to ethics. Ethics provide separate and legitimate grounds for criticizing governments, laws, parties, and policies. They are a manifestation of that side of human nature concerned with individual autonomy, care for others in need, and justification of the occasions when we voluntarily combine our efforts with others at all levels of association – group, communal, political, or international. Our success or failure in applying ethics to public needs directly affects the legitimacy of policies, civic consensus and cooperation, trust in government, and the strength of the democratic state. Respecting ethical principles is not always easy or simple, yet failure to consider ethics always has consequences. Being ethical may itself have undesirable consequences. Something we personally value may have to be sacrificed, but we make the sacrifice (not necessarily *like* doing it) so that an ethical duty to the

public or a public-regarding outcome will prevail, or, harmful consequences will be avoided. Ethics is not about our personal desires.

### **Ethics and Morals**

A criterion people often say they consult in determining what they should or should not do is their "morals." The term morals is often used interchangeably with the word ethics, but technically they are not the same thing. Reasoned conclusions about what is ethical are derived from the analysis of moral statements, such as you should never lie or steal, or never trust a gypsy. Morals involve concrete ideas about right and wrong that we learn from parents, from school, and from peer experience. They tend to equip everybody with rough tools for judging whether the character, actions, or product of actions (one's own or someone else's) are right or wrong. But all morals are not necessarily ethical. Morals are intuitive and variable rules of behavior. They are a starting point for ethical analysis and they may guide one to the right choice. But sometimes they can be dangerous. Hitler and many of his sincere followers thought it was morally right to kill people they considered inferior or to do medical experiments on political prisoners. Hitler's morals were terrible – not justifiable at an ethical level. People's moral positions can be ethically condemned, such as the practice of racism, selling human organs, or the tendency in Central Europe to presume that all Romanies are inferior and cannot be trusted. Thus we see that not every moral position can stand up to ethical analysis and does not, e. g., bigotry or slavery. Ethics is a major tool for restraining our lower impulses to ignore people's needs or do harm to them.

Deeper, more rational analysis and reflection become necessary especially when quick moral judgements still leave one in doubt about what is right or when one idea of morals is in conflict with another one. This is the essence of an ethical dilemma and it is a common challenge in policy work. When the well-being of others is at stake, as it usually is in making public policy, simple and quick *moral* conclusions may not be enough. Since people in a variety of situations are affected by public policy there may be many clashing versions of what is right (and what is wrong). Gutmann and Thompson explain this difference in the following way:

*[Ethical] principles express the rights and obligations that individuals should respect when they act in ways that seriously affect the well-being of others and the standards that collective practices and policies should satisfy when these similarly affect well-being. What distinguishes ethical principles from the purely prudential principles common in politics is their disinterested perspective. Prudence asks whether an action or policy serves the interest of some particular individual or group or nation. Ethics asks whether an action or policy could be accepted by anyone without regards to his or her particular situation such as social class, race, or nationality (1997, p. xii).*

The Gutmann and Thompson book contains many ethically analysed cases studies including cases on energy supplies, employment insurance policies, health care, and welfare reform.

In recent decades in the United States, responding to such incidents as Watergate, Vietnam, and the Iran-Contra scandal, demand increased for applied ethics education in business, public administration, and public policy schools as well as in the civil services of national, state, and local governments. Numerous ethical codes were written, ethics enforcement offices were set up, and more ethics laws were passed. Research and education institutes for studying ethics proliferated. From these efforts we have learned a great deal about institutional (or external) ways to control unethical tendencies, but it leaves open the question of how to strengthen ethics internally, though self control. This was the subject of a great early debate between two political scientists, Friedrich and Finer in the 1950's. Finer believed external controls (formal legalism) were the best ways to deter unethical behavior. Friedrich held that the main line of defence was strengthening internal ethical values (professionalism) of those with public responsibilities along the lines of Kohlberg's reasoned ethics (in Rourke, 1978). Whether better adherence to ethical standards is better achieved by external or internal control, the policy actor must first come to understand the differences between ethical goods and other kinds of goods. Some of these distinctions are discussed next.

### **Ethics and Value Questions**

We just discussed one important set of value distinctions the difference between ethics and morals. But there are additional distinctions worth noting between ethics and other "good" things. These other values have legitimate weight in particular spheres and are not necessarily in conflict with ethics. Among them are legal values (such as rule of law), religious values (such as faith in God), political values (such as majority rule), democratic values (such as pluralism), economic values (such as efficiency and competition), and scientific values (such as getting reproducible results). Other important values include aesthetic values (beauty), engineering values (does it works), and mathematical values (the value of the number seven). In practice, public policy requires balancing all kinds of values and there may need to be tradeoffs, within limits, between ethical values and the other values. The most efficient, the cheapest, most profitable, or the most technically simple solutions may not be the most ethical ones and, importantly vice versa.

The absence of ethical values in the policy process has special significance. If ethical values are consistently absent or violated, all the other values may be called into question, as was the case with communist economic planning. If those who have the authority to make policy are not of good character, or their methods fail to consider the well being of the people, or their results cause more harm than benefit, then the policy makers, their methods, and the policy itself may be considered wrong. Just as there is private profits from good economic decision-making, there is social profit from good ethical decision-making. In most, but not necessarily

all cases, when various kind of values are being considered, **ethical values should take precedence**. One of the most controversial conflicts between different kinds of values is that between ethical and legal values, which we turn to next.

### **Ethics and Law**

Several references have already been made to the differences between law and ethics. While there is considerable overlap between ethics and law, they are not identical. Public policy makers and public officers must above all be aware of where they overlap and where they do not. Legal instruments can be used to advance patently unethical objectives and laws can be used as excuses for simply not performing ethical obligations. Especially sensitive in this regard in CEE states are laws about citizenship, minorities, religion, education, and police powers. This is not an argument to support disrespect of the law – some would say respect for law (rule of law) is an ethical principle. However, respecting laws that deliberately undermine ethical obligations and ends is hard to justify, and peaceful opposition to such laws is ethical.

With special attention to public administrators and policy makers there is a lively debate in professional circles about legal and ethical obligations. Authors like Sharleen Martenas (1991, pp. 1 – 8) argue that one way to view the differences is to look at law as a device for resolving ‘public interest’ problems (i. e., current specific demands of contending private interests) and ethics as another device for resolving the ‘public good’ problems, which transcends the notion of good as material benefits or private interests. The ethical approach is an effort to create a morally good society, a community that cares about and is committed to the well-being, the happiness, and the human dignity of all its members. Martenas believes the legalistic view is predicated on a pessimistic view of human nature. Excessive orientation to laws and rules may in fact erode the integrity of policy makers in that it appears to lift the burden of morality from individual officials as long as they do exactly what the rules specify. If only they obey the rules on the book they are “safe.” Legalism, she says, tries to curtail or eliminate administrative discretion and ethical responsibility. But responsible discretion in interpreting rules is necessary, especially in the execution phase of public policy (Martenas, 1991).

Gregory Foster develops other aspects of this argument. Foster’s position starts with questioning whether a legal system will by itself assure morality, whether immorality should always be punishable by law, and whether the law is open to moral criticism (1981, p. 29). Like Martenas he argues that administrative and policy actors who do not exercise any ethical discretion will lose it and turn ever more diligently to rules, codes, and the law which begets even more laws. To Foster, excessive reliance on these criteria results in timidity, conservatism, technicism, conformity, and indifference to real consequences and higher principles. “The legitimacy of a rule,” he notes, “derives not from its content – its rightness or wrongness – but instead from its source, its form, or the procedure for adopting it.” Thus, rules “become a shield behind which officials may hide (p. 31).” The

public policy ethics literature is thick with such warnings about the importance of distinguishing the difference between ethics and law. In the U. S., slavery, child labour, and drugs were once legal. Only after conscientious (ethical) campaigns were the laws (and policy) changed. In Central and Eastern Europe where laws and the State have exceptional weight, the problems can be acute.

### **Ethics and Economic Values**

Simply calling something a “value,” as we discussed above, does not always mean it is good ethically. Economic values such as competition, price, profitability, and possession are prized for instrumental reasons, some of which can be applied to private benefit or to public benefit. Ethics, however, are always geared to public benefit by definition. Such specific moral values as trust and justice actually help to make possible reliable and fair economic exchanges. Thus someone can enjoy an economic benefit without sacrificing ethical benefits. Some researchers have noted that there has been an excessive preoccupation with economic values in the CEE context and they urge us to recognize that it is not only the market which must be considered in the policies of governments, but also social values (Potucek, 1997). It is legitimate and necessary to help people get economic benefits from public policy, but it is also important that the ethical values not be neglected or discarded in the search for economic payoffs.

In Central and Eastern Europe, policy makers in the early 90’s often confronted dilemmas in determining what rate and kind of price liberalization would balance the overall economic health of a nation with the harms these policies would inevitably visit on the elderly, poor, and unemployed. However, relying on economic values alone did not produce ethical answers. This relationship between economic values and ethical ones was vital because of the prominent role of the State in restructuring the economies of the CEE states. Raising school fees could keep a university financially solvent, but might deny education to many deserving students. Many economists appear to believe that only the invisible hand of Adam Smith produces public good. While there are some ethical values embedded in market institutions and practices, they are by no means sufficient for the realization of justice and fairness in society.

I end this discussion of applications of ethical thinking to economic policy with a set of philosophical questions about the price of things. For instance, is the price of public and even some private goods always a market price, or are there other kinds of prices? The American founder James Madison maintained that we not only possess material property but we also have a certain property in our rights. If we are deprived of them, we lose something of great value. Don’t we also “own” our dignity, reputation, integrity, and honesty as a kind of property? Is there a market price on these? I would also repeat here, with special reference to public policy, the social parallel to private profit, namely, the *social profit* that comes from producing “goods” like more freedom or relief from suffering or inequities. Finally Robert Putnam, the scholar who has become famous for the term ‘social capital,

' has presented social capital as an alternative and complement to the traditional meaning of material capital, hence he has produced another viable argument for the utility of ethics (Putnam, 1993, 1995).

### **Ethics and Ethics Codes**

In America, we find many ethical codes (not laws) written for governments as a whole, for public administrators, and for most professional groups. There are ethical codes for auditors, accountants, budget analysts, doctors, lawyers, and planners. These codes usually indicate what is acceptable ethical practice and what is not. There may be authorized enforcement procedures within the relevant professional associations that develop these codes or there may not be. But an objective of many of these codes is to establish in government organizations and throughout the policy process a positive "climate" of ethical awareness (Mertins, Jr. et. al., *Applying Standards and Ethics in the Nineties*, 1995). The degree of observance, enforcement, and training in support of these codes varies widely. The degree to which they channel behavior and decisions in ethical directions is determined by a combination of leadership, rules, training, and self-discipline. There is considerable controversy about codes given the heavy reliance on self-enforcement, but at the least they indicate the consciousness of the professions that ethics is relevant to their practices.

Experts who work for government are often in positions to profit from the power and wealth concentrated in government. Various safeguards, including ethical codes are considered necessary to restrain these impulses. A discussion of the pros and cons of creating such codes is presented by Benveniste in his "Ethics and Policy Experts: On a Code of Ethics for Policy Experts (1984, p. 563)." He notes that some American policy experts prefer to not be bound by ethical codes because they don't want external constraints and regulations on their efforts to serve their clients, and they want to foster the impression that they only work with the facts, not values. He writes, "Those who work in the upper echelons of government pursue complex, prestigious careers; the satisfaction of participating in high level discussions may submerge their ethical doubts (p. 564)." In Central and Eastern Europe this aversion to control can easily be seen among those who now participate in policy debates.

### **Ethics Applied to Different Decision Making Stages of Public Policy**

Material throughout this volume shows that Western policy specialists do not accept a single paradigm or model of policy making. Johnson, for example, identifies eight stages of public policy: agenda setting, problem definition, identifying alternatives, assessing alternatives, choosing alternatives, implementation, and monitoring and evaluation (1996, Ch. 5). There are many other versions of the steps or phases, the key activities performed, and the primary actors and their roles. In the US the policy approaches or frameworks selected even vary from one policy area to another. Thus, substantial differences of approach can be seen between policy



arenas such as the military, health, business, or foreign policy. Nevertheless, policy studies do reveal some regularities about the typical stages of policy and this has encouraged a search for policy models that might lead to more rational policy strategies. We also know that there are certain basic ethical questions that come up repeatedly when governments try to develop and implement policy. Some of these are outlined below.

Ethics apply to the *identification* of policy problems – does some wrong need to be corrected or do some legitimate and deserved benefits need to be made available? These are ethical questions. Ethics apply to the *content* of policy. Is the substance of policy and what it intends to accomplish respectful of the genuine needs of most people – does it treat people as ends or as means to some end? Can potential harms be defended ethically?. Ethics apply to the *methods* (and assumptions behind methods) that are used in recommending and selecting policy options. Do the methods measure relevant variables, are they accurate, and are the intentions behind their assumptions or execution fair to all who are affected, or are they biased in favor of an undeserving special group? Ethics apply to the *conduct of actors* responsible for any level of policy decisions. Do they seek an undeserved personal or group gain (party, agency, or special group) at the expense of the public? Ethics apply to the *execution* or implementation of policy. Do the means selected to put policy into effect discriminate or do harm to any of those who are supposed to benefit from a policy or fail to inform or compensate those who do not benefit? And ethics apply to the *evaluation* of policies. Is policy continued, altered, or terminated when the evidence shows it is no longer working at all or is doing harm? Is it terminated because a special group is hostile to it even when it is working well? Again we see that ethics is about much more than personal behavior.

In many cases of public policy making it may be easy to specify the principles of good that should be maximized or at least recognized. In some cases, however, it may be very difficult, very controversial, and extremely important (to the well-being of citizens, the stability of government, or to the broader problems of social integration) to choose between alternatives. When it is so hard to choose between the mixes of good and bads implicated in any part of policy development we have an ethical dilemma. Ethical dilemmas require careful reasoning and analysis in their own right. Dilemmas are not merely issues to be handled ethically but fundamental clashes of moral or ethical principles themselves as in the case of capital punishment where we face the question of whether the state has the right to take a life in situations other than war or law enforcement. Dilemmas occur when we discover clashes between different moral claims such as beneficence, compassion, duty, justice, or respect. Managing such dilemmas may be hard, but handling the consequences of wilful violations is worse.

Corruption can reach any part of policy work. Constant attention is necessary to prevent it. Noble goals can be subverted by conflict of interest, bribery, greed, or favoritism. In states undertaking the perilous transition to democracy,



civil society, and liberal markets there is a high risk that the ethical practices and the climate necessary for them to become normal or habitual may not take shape properly. This is especially difficult in former Soviet countries where new behaviors, procedures, and structures must overcome a legacy of misbehavior and abuse of policy processes. Where administrators, analysts, lobbyists, or politicians assume that citizens cannot be trusted with access, information, or participation, or where they assume government automatically knows what is best, both ethics and democracy will be retarded and threatened. Professionalizing the public policy process is still in its infancy. Efforts to create clean policy procedures and content require helping participants recognize ethical dilemmas and appreciate alternative ethical solutions.

### **Ethics in the Public Policy Analysis Stage**

We will now take a closer look at some specific and significant ethical issues that the US literature has focused on in just one part of the policy process. Earlier, we noted the views of Benveniste on how the integrity of the analyst can be seduced by the rewards of associating with the top decision makers, leading them to both ignore their own conscience and resist any external controls. Analysts often argue or rationalize that ethics is too unscientific. Douglas Amy, considers this issue in "Why Policy Analysis and Ethics are Incompatible," and he observes that:

*Commentators in the field of policy analysis have argued persuasively for the inclusion of ethical evaluations in the analytical process, yet most practitioners in the policy field avoid analysing moral issues. Standard explanations for this neglect of ethics tend to be inadequate – assertions that moral analysis is unnecessary, impractical, impossible, or undesirable are demonstrably weak. Political factors, on the other hand, provide a clearer understanding of the neglect of ethics. Ethical inquiry is shunned because it frequently threatens the political interests of both analyst and policy makers. The administrator, the legislator, the bureaucracy, and the professional policy analyst himself all resist the potential challenges of moral evaluation (Amy, p. 577).*

Amy disagrees with the claim that explicit ethical analysis is unnecessary because cost-benefit analysis already evaluates normative (ought) questions and that combined with political review of values at higher level, it is one of the best tools available for most policy making purposes. Amy cites a variety of experts who say cost-benefit analysis is not only fraught with methodological problems, it is also severely limited in its scope of evaluation. Cost-benefit analysis only seeks to maximize one value- efficiency – but frequently other values compete and conflict with it, yet are given no weight in the analysis. Even economists, the main champions of cost-benefit analysis, admit that at least one other value – equity – ought to be considered in policy choices. In fact there are a number of other ethical concerns

besides equity such as justice, fairness, and trust that also merit considerations in policy decisions (Amy, 387).

Continuing and deepening this critique Amy charges that:

*In cost-benefit analysis, ethical inquiry is conveniently reduced to a process of calculation. Instead of a difficult philosophical procedure that examines clashing moral arguments, the analysis becomes a technical activity largely concerned with price determinations. It is this objective, empirical appearance that has made cost-benefit analysis one of the favored decision-making tools of analysts and administrators. Ironically then, cost benefit analysis is popular not in spite of its ethical and intellectual shortcomings but because of them, for it is these very shortcomings that make the technique politically and professionally acceptable (p. 590).*

So the tendency of analysts is to avoid messy ethical issues. But, as Brewer and DeLeon caution, “knowing what counts is as important as how to count (1983, p. 381).”

Still another rationalization that some analysts use to keep ethical questions at arms length is to say they must remain neutral and not question the structure of decision making laid down by their superiors. One problem with this is that it may reflect a misplaced faith in hierarchy, an over reliance in this case on the assumption that all necessary ethics will be considered at higher levels. Cox, Buck, and Morgan address this issue in the following way:

*Practitioners have tried to ignore the moral aspects of their jobs by invoking the ethic of neutrality, which holds that administrators are to give effect to whatever principles are reflected in the orders and policies they are charged with implementing. Classical understandings of bureaucratic structure and organization theory have provided little in the way of an ethical basis for administrative activity. . . . Individual morality had no role to play in the popular (Weberian) conception of bureaucracy. The morality of policy decisions was a problem for politicians not the administrators. A chilling example of neutrality is [was] Adolph Eichman’s defence of the Nazi slaughter of the Jews: He was only following orders and thus was free of moral responsibility for the deaths (1994, p. 17).*

In her book *Ethics and Policy Analysis*, Rosemarie Tong tries to clarify what ethicists can do and what public policy analysts can do about ethics. Leading us directly into the next section of this chapter, she clarifies what she believes are the specific benefits of some formal preparation in the study of ethics:

The prospective policy analyst or administrator who takes a course in public policy ethics can hope to be trained to perceive moral issues, conscientiously to grasp and appreciate the range of values that are at stake in a policy choice, and to

employ a rational method of ethical decision making rather than rely on hunch and intuition. Learning these things does not make a citizen, policy analyst, administrator, or legislator into a professional ethicist. Instead, it helps one to function at work as an ethically sensitive and morality informed person (1986, p. 86).

### **Ethics Education, Training, and Research for Policy Professionals**

Most CEE legislative and administrative offices do not have policy staff with the backgrounds, incentives, or instructions to engage in focused ethical analysis of policy proposals. Most outside consultants lack this preparation as well. University social science graduate programs (and science academies), where one might expect to see attention paid to these problems are still only beginning prepare their people to play a fuller role in generating policy options and their ethical analysis. This doesn't mean there are not some people of conscience in these positions, but they usually operate without benefit of training in ethics. There is also a meagre supply of applied ethics literature available in CEE languages with which to educate and train students or practitioners. Although all the citations used here are in English, they illustrate the vast reservoir of useful materials available that could be translated and published locally. Faint efforts in Central and Eastern European countries to find, translate, and utilize professional public policy ethics research is perhaps a surrogate measure of the incomplete status of public policy analysis in general. What can explain this oversight in preparing for democracy?

For decades both religious ethics and philosophical ethics were not taught in the Soviet controlled world. Marxists, even when they acknowledged the two thousand year tradition of ethical teaching, sought to discredit it. But in the West over the same period there was continuous access to formal education in ethics. Through this exposure ethical teachings infused youth and sports organizations, professional training, the work of philanthropic foundations and advocacy groups, ethnic and gender causes, and various social bodies. When there were public scandals and famous corruption cases they simply animated those in public life to press for more ethics laws, ethics offices, codes of ethics, and ethics training programs throughout the public agencies. None of this would have been necessary if ethics was easy to understand and practice. Policy actors in Western countries have few excuses for claiming ignorance about basic ethical expectations given the high profile of moral discussion and the institutional controls that surround them. If nothing else, this shows ethics is a valuable but difficult social project.

CEE countries must commit to such a project if they wish to complete their economic, political and social transformation and create a fully democratic policy environment.

One aim of ethical awareness training (as Tong emphasizes above) is to help the analyst, consultant, manager or politician learn more about what is expected from a person of integrity, character, and virtue. In America an increasing numbers of think tanks, public policy institutes, and university consultants offer ethics training or advice. In some hospitals ethics "experts" are hired full time to help administra-

tors, doctors, and nurses cope with difficult health care dilemmas. Many public administration programs in American universities offer a course in administrative ethics. Government ethics is a frequently featured subject in professional journals as well as weekly news magazines, newspaper stories, and TV documentaries. When the State of Oregon developed its policy on managed health care, ethics debate forums for citizens were organized by the government at many levels and influenced the outcomes.

In the CEE countries it is rare to find ethics training programs in public agencies, universities, or institutes. The still very weak professional associations (if they exist at all) have neither developed ethics codes nor given seminars to their members. Too often, as noted above, ethics is treated as ideology, as it was under Marxism, or religion, as it often was under the Austro-Hungarian Empire. Today it is too often treated as simply following the law or economic rules. These perspectives, as discussed above, are incomplete and do not serve public policy well.

Pointing out the low level of study and of attention to ethics in CEE should not be taken to mean that Western Europe or America is a paragon – the perfect model for CEE. Responding to what he considered warnings about directly copying the American system of democracy, Campeanu notes, “. . . we should inform ourselves more completely and less selectively about the realities of the United States; and second we have to accept the idea that there is no perfect democracy that could simply be industriously imitated (1993, p. 3).” In this perspective every nation is endlessly learning about what principles of ethics are important to cultivate and when they should be applied, and what to do about their violation. Studying ethics in many countries helps us know both what is right (and works) and what is wrong (and should not work).

Many authors have developed frameworks for helping public officials and analysts to make ethical decisions (Cooper, 1990; Rohr, 1978). In most cases these works recognize that ethical values must be balanced against other values such as legal, economic, technical, and political values and they try to show how to do it. Van Wart, in his *Changing Public Sector Values*, also lays out an ethical decision making paradigm for public managers. The book has several excellent chapters on specific values that need to be clarified when making ethical decisions (1998). Still another recent effort to present a framework is made by Guy Peters in a chapter, “Ethical Analysis of Public Policy,” in his book, *American Public Policy: Promise and Performance*, where he also addresses the ethical questions which should be raised, starting with the articulation of policy intentions, through to the evaluation of policy effects (1996). All these sources could be useful ones in Central and Eastern Europe.

### **Reprise: Basic Concepts Reviewed**

In the discussion above I have addressed not only elected and administrative policy makers, but also those who analyze and advise, implement, criticize, and evaluate

policy. Ten of the concepts discussed bear emphasis and they will be very briefly mentioned again to remind the reader of their salience to the ethics discussion.

1. The first, and thematic idea of this chapter is the recognition that by standards of both theory and practice ethics is "incomplete," or not yet redeveloped in the CEE region. Ethics conceptualized and practiced in public policy has actually been un-developed (not necessarily eliminated) by decades of neglect and violation under communism. Deliberately restorative efforts are needed.
2. Ethics serve practical human purposes. They are not luxuries, not expendable, and cannot be just seasoning if a government want to retain its legitimacy or if the people are to be satisfied with the outcomes of policies allegedly made on their behalf. Genuine concerns with producing ethical results are necessary to stability, predictability, and cooperation among diverse groups in modern societies.
3. Ethics is not identical to values. Ethics is but one type of value. Ethics in fact help the policy maker judge between other values such as economic, political, or technical ones. When ethical analysis reveals distinctions between the just and the unjust or what ought or ought not be done the selection must favor the just and fair. Among the biggest mistakes in determining what is ethical is when people equate ethics with "personal ethics" or promote the notion that all ethics are relative. They are not.
4. In CEE and much of Europe, (differing from the USA), it is governments which in most cases are the primary initiators of public policy and thereby have special obligations of providing moral leadership. This is especially true since intermediate institutions and individuals in so many cases were de-moralized and manipulated in the past. Until civil life and economic and non-governmental organizations reclaim and revitalize their own moral consciousness, these States and their governments will have special burdens of moral stewardship – setting good examples for moral behavior and decision making.
5. Weakness of political democracy in CEE is in part related to moral weakness of civil society and economics. This is an extension of point four. State actors will not behave and decide ethically if they do not think market and civic actors expect it of them. Individuals and leaders of economic and social organizations will not do so if they think the State will not make policies which are ethically substantial. This reciprocal relationship can work in the direction of enhancing or undermining the ethical climate. The media has a special role in 'mediating' communications among these sectors; if it is independent, it can help with the task of restoring the ethical climate.
6. Ethics is to some extent 'embedded' in many democratic, economic, and civic organizations and processes. When Western style courts, elected legislatures, stock markets, foundations or social clubs are formed, they usually carry with them rituals, rules, and requirements which make them likely to conform to at least minimum accepted standards of conduct. The central question is how deeply are the ethics embedded in them. It could be deep or superficial. Can a

minimum of fairness and truthfulness be expected from their operations even if individuals try to exploit them? But the fact that ethical qualities can become embedded in them should not lead automatically to accepting that ethics or democracy are complete where these institutions exist. Systemic corruption can develop even in large old organizations. Legitimate institutions can be manipulated and undermined by cynical or unscrupulous leaders. Vigilance is a protection for both democracy and ethics.

7. The ethics of public policy refers to much more than whether politicians finally make choices based on ethical considerations. Every facet and stage of public policy can involve ethics and all the actors involved must address ethical questions. Advisors, analysts, decision makers, administrators, and evaluators are ethically accountable. They are accountable for their behavior as agents of the public, for the methods they use, the content they focus on, and the outcomes of the policy.
8. Using America or Western European as a models of how to include ethics in public policy does not imply that they are paragons of the ethical state. They are not. But the slogans often heard in CEE countries about “a return to the West” or “a return to Europe,” imply that many of the institutions and processes of the Western tradition are considered better or more advanced than any of the known alternatives. There is corruption and meanness in some Western ways of making policy and in the content of some policies. But there are also valuable lessons about the place of ethics in open, democratic societies as well as the cost of unethical decisions. To a large extent ethical safeguards are built into their structures alongside political principles such as pluralism, basic rights, rule of law, and respect for minorities. They are also found in more concrete mechanisms such as ombudsman offices, campaign expenditure limitations, and professional codes. These encourage ethical forthrightness and place limits on the inevitable tendencies of some to pursue greed, self-interest, and exploitation of others.
9. Ethics can be learned by policy analysts and others who regularly participate in the policy process. Adult professionals in all walks of life are not predestined to act on the moral programming of the past. People every day undertake new careers and join new organizations in which they learn new cultures, new rules, and new morays. Just as Central Europeans learned to adopt the values of the communists for protection, they can learn the values of an open society, democracy, and modern market economies. Public servants can be trained in new habits of mind. Professionals can adopt new codes and practices.
10. Frameworks for ethical decision making exist to aid public policy actors and policy students in doing ethical analysis and making ethical choices. There are textbooks, and training manuals available whose explicit objective is to help decision makers, advisors, and implementers identify the ethical elements of a situation, examine ethical alternatives, and make rational ethical choices. These resources are seriously underutilized. It is rare to see courses on practical ethics

in CEE universities. It is rare to see ethical practice frameworks used in civil service training. But it is more than possible, if the desire is there, to introduce these learning aides into universities or policy institutes, or training centers, and in the public agencies themselves.

## Conclusions

In most CEE countries personal freedoms have been restored, parties can compete for votes, fair elections can be held, and parliamentary institutions can operate. Mature democracy, however, is not achieved until civic mindedness and ethical standards are strengthened and grow. There remains a large gap in all CEE countries between where they are now and where they should be in developing these "habits of mind." These States have not yet fully committed to policies and programs which themselves are designed to encourage ethical citizenship, ethical government, and an ethical vision for the State. They have not yet taken full advantage, during this crucial transition stage, of ethics instruction and instruments. Public policy making is not oriented yet to processes that demonstrate government commitment to systematic or energetic pursuit of ethical regimes. Instead, the emphasis is on rule of law and the embedded ethics found in Western type institutions, which are useful, but not enough.

Steve Kettle in a *Transition* article entitled "Of Money and Morality," notes that the transformation of CEE countries cannot be declared to be closed, leaving only the fine tuning of institutions and procedures, if ethics are not more encouraged and recognized (15 Mar. 1995, p. 39). Even where there is positive political and economic performance, it is possible that extensive and unnecessary violations of ethical principles can still occur. Laws and official procedures (especially if deficient in staff and resources, which is so often the case) cannot by themselves deal with bribery, deception, nepotism, insider trading, influence peddling, tunnelling, and a long list of other wrongs. Also needed are professional codes, ethics education, ethical leadership, and a robust mixture of non-governmental associations that monitor, criticize, and participate in policy discussions about the public good. The institutional, political, and social realms remain fragile and untested by major economic, ideological, or military challenges. Building an ethically sound public policy process is one of the important means to help these nations meet such inevitable challenges.

There are well-developed, practical sources of ethical information, instruction, frameworks, and experience available to the CEE countries. They should be considered as an important type of technical assistance and direct investment – a kind of necessary social capital. Governments are obligated by law, ethics, and public interest to protect the people as well as provide public benefits that address genuine basic needs. This is fulfilled through the workings of public policy. People and their governments are endangered if ill will, selfishness, and mistrust prevail in the wider culture or are reflected in the attitudes and processes that guide public policy.

At the end of this investigation of the role of ethics in public policy making we see a profound puzzle before us. Today, many key actors in the process are largely uninformed about modern methods (and theory) of public policy analysis and development, but the need to act is pressing and unavoidable. A new generation of officials and experts will not be available for some time and during this second decade of transition the current decision makers are establishing policies and using methods that will set precedents for a long time to come. Meanwhile, ethics in both the government and society is in an underdeveloped state and no systematic plans or programs exist to raise these standards although this is critical for the legitimacy of governments and their policies. This indicates that whatever steps are taken to improve the understanding and execution of policy work they must be accompanied by efforts to also improve the understanding of the role of ethics with equal and urgent emphasis.



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# Chapter 9



# Evaluation of Public Programs<sup>1</sup>

*David Greenberg*

## **Purposes of Evaluation**

This chapter focuses on the evaluations of government policies, regulations, projects, and programs. As used in this chapter, the term “evaluation”, simply refers to techniques used to assess whether existing programs are working and whether they can be improved or whether a proposed new program or policy is better than what currently exists. Thus, the objective of evaluation is to help policymakers answer the following sorts of questions so that they can make better decisions about government programs and policies:

- Should a new government project (say, a dam) that is being advocated by an interest group actually be implemented?
- Is an existing program not working? Can it be improved? Should it be terminated?
- If several policy alternatives are being proposed, which should be selected?

For reasons discussed in this chapter, evaluations rarely provide definitive answers to such questions. If they did, political decision-making would be much less controversial and interesting. What they can do is provide some guidance to policymakers in making decisions. Previous evaluations that have been conducted throughout the world have almost always been funded by government agencies or legislatures. They have sometimes been conducted “in-house” by government agencies and sometimes by consulting firms or by academics who specialize in evaluation. Many evaluations have been inexpensive, but others have been costly. In the latter instance, the justification is that it is worth expending a fairly large sum of money to help avoid serious errors in policy making that might cost much more.

Evaluation studies of the sort described in this chapter have so far been comparatively rare in Central and Eastern Europe. To illustrate, government-funded training programs and other active labor market programs for the unemployed have been a frequent subject of evaluation in North America and Western Europe, but not in Central and Eastern Europe. For example, Kluve and Schmidt (2002) list 14 European evaluation studies of active labor market programs conducted between 1999 and 2001 (Table 2). Of these, one is for programs in Poland and another is for programs in the Slovak Republic; the remaining 12 are for programs in Western Europe. Similarly, Heckman, LaLonde, and Smith (1999) list 36 evaluations of European job training programs conducted between 1978 and 1997 (Table 25). None of them are for programs in Central or Eastern European countries. It seems

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<sup>1</sup> In this chapter, the term “public programs” is used to refer to policies, regulations, projects, or programs that are promulgated by the public sector.

likely, however, that use of the tools of evaluation in Central and Eastern Europe will grow in the near future. Such growth has recently occurred in Western Europe. For example, of the 36 studies listed in Heckman, LaLonde, and Smith (1999), all but eight were conducted during the 1990s.

The rest of this chapter consists of six sections. The next section, which is quite brief, discusses why policy evaluations almost inevitably involve comparisons of some sort. The third section contrasts evaluations conducted prior to initiating a program with those conducted after the program has been introduced. The fourth section describes cost-benefit analysis, which, as will be seen, is the most comprehensive type of evaluation, but also the most difficult to conduct successfully. Thus, two well-known alternatives to cost-benefit analysis – cost-effectiveness analysis and multi-goal analysis – are briefly considered in the fifth section. The sixth section describes impact analysis and process analysis. As will be seen, not only are impact and process analyses essential components of cost-benefit, cost-effectiveness, and multi-goal analyses, but they are also valuable in and of themselves. Indeed, often one or both of them is all that is done in evaluating a program, and sometimes that is all that is feasible, or all that is needed. The concluding section briefly discusses using findings from evaluations in the policy process. We illustrate some of topics discussed in the chapter by briefly describing an evaluation study of active labor market policies in Poland and Hungary (O’Leary, 1997).

Because of limited space, this chapter can do little more than introduce the major approaches to the evaluation of government programs and briefly consider some of the more important issues that conducting such evaluations raise. While it should help readers interpret evaluations performed by others, it does not provide the details needed to conduct one’s own evaluation. Thus, the reader who desires more detailed information should consult some of the useful books that are available. Specifically, three good book length general treatments of evaluation are Posavac and Carey (2003), Weiss (1998), and Freeman and Rossi (1999). A book edited by Bickman and Rog (1998) provides individual chapters that cover each of the major tools used in evaluation. A recent book that focuses specifically on cost-benefit analysis is Boardman et al. (2001), while the best-known text on cost-effectiveness analysis is Levin and McEwan (2001).

### **The Role of Policy Comparisons in Evaluations**

An important characteristic of evaluations is that they almost always involve some sort of comparison between alternatives. For example, in assessing a proposal for a new government project (for instance, a new football stadium) one almost automatically makes a comparison with what would happen if the project (the old stadium) continues to be used. Similarly in evaluating an existing government program, one tends to compare the program with what the world would look like if it were eliminated.

These hypothetical alternatives with which existing programs are compared are often referred to as “counterfactuals.” Counterfactuals are required to answer

the “what if” questions that evaluation inevitably poses: What if we eliminate program X or implement program Y instead of X – for example, build the new football stadium, rather than continue to use the old one? Answers to such questions typically require estimates of differences between what we actually observe and the counterfactual, differences that are often referred to as “policy impacts.” For example, if average attendance at the old stadium has been 30, 000 and the anticipated attendance at the new stadium is 35, 000, one policy impact is projected to be an increase in attendance of 5, 000.

### ***Ex Ante Versus Ex Post Evaluations***

Evaluations can be classified in terms of whether they take place before or after a program is initiated. This distinction is important because it determines the way in which the evaluation is conducted and the manner in which the evaluation aids policy making.

*Ex ante* evaluations are done in advance of making the decision to implement a specific program. They assist in the decision about whether scarce social resources should be allocated by the government. They are typically subject to considerable uncertainty because they inevitably require forecasts of the size of policy impacts.

*Ex post* evaluation, in contrast, is conducted at the end of a program. For example, after a football stadium is built. Because *ex post* evaluations are conducted at the end of programs, there is, by definition, no uncertainty about what the actual impacts of a particular program were (apart from measurement uncertainty). But, it is too late for this type of evaluation to tell us whether we should have allocated resources to the program in the first place.

While *ex ante* evaluation is most useful for deciding whether resources should be allocated to a particular program in the first place, *ex post* evaluations provide valuable information that can be used in making projection of impacts in future *ex ante* evaluations. For example, estimates of the impact of a new football stadium in one city might be used to predict what the impact would be should a similar city build a stadium. In addition, *ex post* evaluations provide information not only about the particular government intervention that is evaluated, but also about the “class” of such interventions. In other words, such analyses contribute to “learning” by government managers, politicians and academics about whether particular classes or types of policies are worthwhile – for example, agricultural subsidies and price regulation. Eventually, the weight of evidence from such evaluations may lead to policy changes.

In practice, many evaluations are performed during the course of the life of a project, that is, “*in medias res*.” These studies provide information that can sometimes be used to improve an on-going program. They are also particularly useful in the case of programs in which variable costs are a high proportion of total costs – for example, programs that provide services to people – and, hence, resources may be readily shifted to alternative uses. In such cases, *in medias res*.

evaluations can be used for determining whether an on-going program should continue. Where sunk costs are high (and variable costs are low), the benefits of continuing a program will often exceed the costs. As a result, an evaluation is unlikely to recommend termination. For example, an evaluation is unlikely to recommend closing down an operating dam, but may recommend terminating an on-going training program for the unemployed.

### **Cost-Benefit Evaluations**

Evaluations take many forms. This section considers cost-benefit analysis, which, at least in its purest version, can be viewed as the pinnacle form of evaluation. However, cost-benefit analysis is often a more elaborate and expensive form of evaluation than what is really required. And in other instances, as will be discussed in this section, cost-benefit analysis – or at least the pure version – is simply infeasible or impractical. Thus, the section following this one discusses two alternatives to cost-benefit analysis – cost-effective analysis and multigoal analysis – that can be used instead. And Section VI describes impact analysis and process analysis. As will be seen, these are not only essential inputs to cost-benefit analysis (or cost-effective analysis or multigoal analysis), but under certain fairly common circumstances, they are all that are needed.

#### *What is Cost-Benefit Analysis?*

In the simplest terms, the objective of cost-benefit analysis is to determine whether the benefits from an existing or proposed government program less the program's cost are positive or negative. In other words, in conducting a cost-benefit analysis of a government program, all the benefits from the program are summed, all the costs are summed, and then the total benefits are compared to the total costs to see if the program results in a net gain or loss to society as a whole:

$$\begin{aligned} \text{TOTAL SOCIAL BENEFITS} - \text{TOTAL SOCIAL COSTS} &= \\ &= \text{NET SOCIAL BENEFIT} \end{aligned}$$

The emphasis here is on program impacts on society as a whole – everyone who is affected – not just an individual firm, a sub-group of individuals, or a particular government agency. Ideally, the total value to society of the output produced by the program being analyzed should be compared with the total social value of the resources needed to produce that output, and policy decisions should be based on whether differences between the two are positive or negative. A positive value would imply that the program increases efficiency in the overall economy and a negative value would imply that efficiency is decreased.

Consequently, if economic efficiency is the sole criterion used for decision-making – an issue that will be taken up later – a cost-benefit analysis that accurately measures net social benefits can be readily used to answer the questions posed earlier. For example, a projection of positive net social benefits would imply that a proposed project should be undertaken. Similarly, an estimate of negative net



benefits for an existing program would indicate the program should be modified so that positive net benefits can be obtained, and if that is not possible, then it should be terminated. Finally, if several policies are competing, the one that produces the largest net positive benefits is the one that should be selected, for it is this policy that will maximize the benefits received by society; in other words, it will do the most to increase social efficiency.

*Using the Findings: Net Benefits Versus Benefit-Cost Ratios.*

Findings from cost-benefit analyses are typically summarized in one of two ways: as net benefits or as benefit-cost ratios. Net benefits are computed as indicated in the previous sub-section, while benefit cost ratios are computed by dividing total social benefits by total social costs.

In general, the first approach is preferred. To see why, consider two competing projects, only one of which can be selected. The first has total social benefits of 500 (as measured in some monetary unit) and total social costs of 300. The second has social benefits of 225 and social costs of 100. Thus, the net social benefits resulting from the two projects are 200 and 125, respectively, while the benefit-cost ratios are 1.67 and 2.25, respectively. Although the second project has the higher benefit-cost ratio, selection of it would result in a loss of 75 (200 – 125) in net benefits to society.

*Why Do Cost-Benefit Analyses in the Public and Private Sectors Differ?*

It should be evident that cost-benefit analysis can be used for decision-making in the private sector as well as in the public sector. For example, if a private sector firm is considering purchasing a new piece of equipment, it presumably looks at whether benefits from the equipment (for example, labor savings) exceed the cost of purchasing the equipment. There are, however, at least two reasons why public sector cost-benefit analyses are both different and more difficult than analyses in the private sector.

First, private sector decisions concerning policy changes are usually assessed solely or mainly from the perspective of those who own the firm considering the changes by focusing on what their effects will be on profits. However, as previously indicated, public sector policy decisions should, at least in principle, be evaluated in terms of their effects on society as a whole. Consider, for example, traffic congestion that results from travel to and from a football stadium constructed with private funds and similar congestion resulting from a stadium constructed with public funds. In both cases there would be costs resulting from lost time to those drivers who are *not* attending the games, but merely sharing the streets with those who are traveling to the stadium. This cost need not be taken into account in reaching a decision on the privately funded stadium, but should in making a decision on the publicly funded stadium. Profits from the private stadium are not affected by the cost, but members of society are and costs imposed on them are highly relevant in making the decision on the publicly funded stadium.

A second major difference between private and public sector evaluations is that market set prices can usually be used in assessing the effects of private sector changes, but this often is not the case for public sector evaluations. For instance, a private sector firm knows what it must pay for a new piece of equipment, how many units of labor the machine should save, and what it now pays for the potentially saved labor. The situation is often more complicated in assessing public sector programs because market set prices may either not provide good indicators of the social value of benefits and costs or may not even exist. Consider, for example, the time lost in travel as a result of the publicly funded football stadium mentioned above by drivers who are not attending the games. Although the wage rate of these drivers can be used to value their lost time, this may not very accurately reflect the value that these persons put on the time they spend waiting in traffic. And for some people – for example, those who are retired or unemployed – there are no wage rates.

### *Issues in Conducting Cost-Benefit Analysis*

The previous section touches on some of the issues that arise in conducting cost-benefit analysis, and there are others as well. The more important of these issues and some approaches to addressing them are discussed in this section.

#### *Standing – Whose Benefits and Costs Count?*

In conducting a cost-benefit analysis, the analyst must first decide who has “standing,” that is, whose benefits and costs should be counted. As already indicated, in public sector cost-benefit analyses, the benefits and cost of all members of society should, in principle, be counted. This, however, really begs the question because “society” must be defined. In evaluations, this frequently takes on either a geographic or a generational dimension. For example, if a town undertakes a program that is partially funded by the national government, the question arises as to whether costs imposed on taxpayers from other parts of the country should be considered in assessing the program. Somewhat similarly, if regulations are being considered to reduce pollution in a river that flows into another country, a decision must be made as to whether to count the benefits received by the citizens of the other country. Moreover, even within the country, the quality of water in the river has implications for the well-being of future generations. Should the impact on them be counted?

There is no obvious answer to questions concerning standing. Typically, decisions on standing must be based on judgment. For example, in cost-benefit analyses that have a geographic dimension, “society” is typically defined to include all the citizens of the nation undertaking the program being evaluated, but not the citizens of other nations. As will be discussed later, the implications of government policies for future generations frequently receive little weight in cost-benefit analysis.

*Quantification, Monetization and the Role of Shadow Prices*

A key to successful cost-benefit analysis is making all benefits and cost “commensurable” – that is, expressing all of them in the same units of measure so that net benefits can be computed by summing them. This means that the impacts of government projects must first be quantified and then they must be monetized – that is, valued in money units. Techniques that can be used to measure the size of impacts are described later in the chapter. Here, we discuss monetization.

Monetization of different benefits and costs resulting from government programs can be usefully viewed as occurring along a continuum. At one end of this continuum are benefits and costs that can be measured in terms of prices that are set in well-functioning, competitive markets. At the other end is the complete absence of a market in which a benefit from a government program is traded. We next consider three points along this continuum.

The first point pertains to situations where market prices both exist and accurately reflect social values. Under such circumstances, monetization is rarely an issue. For example, if labor markets are operating under perfect competition and under full employment, the social cost of hiring a worker who is currently earning €20, 000 a year to work on a government constructed dam for a year is about €20, 000. This is because the social value of the worker’s current output is approximately what he is presently being paid: €20, 000. In other words, if the worker is taken away from what he is currently doing and put to work building a dam, the cost to society is foregoing the €20, 000 of output that the worker previously produced.

A second point on the continuum pertains to situations that involve important market failures such as monopoly, public goods, and externalities. As a result, market prices provide a poor measure of the social value of the benefits and costs resulting from a government program. For example, the production of paper causes air pollution. Thus, if the government purchases a large quantity of paper, and producing this additional paper causes an increase in air pollution, then this results in a social cost (a negative externality) that probably will not be fully reflected in the price of the paper. If it is not, the market price of the paper will understate the true cost to society of producing the paper.

The third point on the continuum pertains to situations where there are no markets. Consequently, prices do not exist that can be used to place values on costs and benefits. One example is government programs that increase the health and safety of a group of citizens – for instance, a requirement that cars contain safety belts and that drivers and riders wear them. A second example is a dam that destroys a beautiful vista. Lives and attractive views are rarely exchanged in markets.

Because market prices do not exist in the third situation, and imperfectly reflect social values in the second, “shadow pricing,” which is an attempt by evaluators to assign values to benefits and costs that come as close as possible to reflecting their actual social value, is often used. For example, as suggested above, prices charged by

paper factories will typically understate the full cost to society of producing paper because the production process generates pollution. Given such circumstances, an evaluator may adjust the market price of paper upward to account for the negative externality resulting from the pollution. This adjusted price is one type of shadow price. Another important example of shadow pricing is the considerable effort that economists have put into attempting to place an appropriate value (that is, price) on human life.<sup>2</sup> Similarly, economists have also put much effort into trying to determine the social value of recreational areas such as public parks.<sup>3</sup>

In the actual conduct of evaluations, it is often impossible to monetize some benefits or costs or, even if it is possible, the evaluators may not have sufficient resources available to do so or may not have very much confidence in the resulting values (for example, estimates of the value of life). In such instances, it is obviously not possible to obtain an estimate of the full value of the program's net social benefit. Yet, evaluation is still feasible. One approach is to select one of the alternatives to cost-benefit analysis described in the Section V. Another approach is to first obtain monetary measures of as many benefits and costs as possible. These can then be summed into a partial estimate of the project's net social benefit. The remaining benefits and costs can then simply be explicitly listed, and whenever possible, numeric values that furnish some indication of their order of magnitude can also be provided.

Although this approach is certainly not as satisfactory as a cost-benefit analysis in which all the policy impacts are quantified and monetized, it can be quite useful, especially if the partial estimate of the program's net social value and the remaining benefits and costs all tend to point in the same direction. For example, in an evaluation of an alternative treatment for mentally ill patients (Weisbrod, 1981), it was feasible to put monetary values on many of the impacts of the new policy; but this could not be done for changes in the status of the patients' mental health. Consequently, the evaluators instead reported changes in several indices of mental health status – for example, frequency of suicide attempts, attendance at social functions, expressions of anger, and self-reported patient information on satisfaction with life. As it turned out, all these indices implied that the treatment improved mental health status. Thus, they reinforced the positive partial estimate of net social benefits that was also obtained.

### *Comparisons of Benefits and Costs Over Time: Discounting*

Because most people would rather receive benefits today and pay costs as far into the future as possible, rather than the reverse, benefits and costs that occur in different time periods are not directly commensurable, even if they are fully mon-

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<sup>2</sup> For a discussion of the methods used to do this and a brief summary of findings from studies of the value of life in the U. S., see Boardman et al. (2001; pp. 334 – 336, 392 – 395). Richárd Adorjan (2002) has conducted an interesting study of the value of life in Hungary.

<sup>3</sup> See Boardman et al. (2001; pp. 339 – 351, 402 – 403) for a discussion of methods and a brief review of findings from these studies.

etized. To make them commensurable, an interest rate is used to discount future benefits and costs relative to present benefits and costs in order to obtain their “present values.” The need to discount arises due to most people’s preference to consume now rather than later. By discounting, benefits and costs that occur in different time periods are made commensurable.

In discounting, when benefits and costs arise over time, the following formula can be used to compute at the present value of the net social benefits or, in short, the net present value (NPV):

$$NPV = \sum_{t=0}^{\infty} \frac{B_t - C_t}{(1 + r)^t}$$

where

- $B_t$  = benefits over time
- $C_t$  = costs over time
- $r$  = discount rate
- NPV = net present value

This equation implies that an analyst first calculates the value of net social benefits for each year ( $B_t - C_t$ ), then uses the discount rate to compute the present value of each of these annual net social benefit amounts, and finally computes the NPV by summing the present value figures for the different years. Although there is not space to discuss it here, the reader should be aware that there is considerable controversy over the appropriate rate to use in the NPV formula.<sup>3</sup>

Because the dominator of the NPV formula becomes larger with each succeeding year, years in the distant future tend to have less influence on the estimated net present value than years in the near future. Indeed, after 30 or 40 years, the denominator is typically quite large relative to the numerator and, consequently, benefits and costs that occur in these years contribute little to estimates of the net present value. Thus, as mentioned earlier, the effect of a government program on future generations has little influence in most cost-benefit analyses.

*Comparisons of Benefits and Costs Across Income Groups: The Role of Distributional Weights*

Even when all benefits and costs are expressed in monetary terms and have been appropriately discounted, commensurability may still not exist. This would occur, for example, if policymakers were not only concerned with the economic efficiency of the programs being evaluated, but also with their effects on the distribution of

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<sup>4</sup> See Boardman and Greenberg, 1997 and Moore, Boardman, and Greenberg, 2001, for discussions of this controversy, as well as details about how to compute the net present value under different circumstances.

income. And they believe that a benefit received or a cost incurred by one group of people is not commensurable with the same benefit received or a cost incurred by another group of people. For instance, it is sometimes argued that a sum of money received or paid out by the poor should be valued more highly than the same sum received or paid out by the rich.

In principle, an approach that can be used under such circumstances is to weigh the benefits and costs of each group differently. For example, benefits received and costs incurred by poor people could receive a larger weight in conducting cost-benefit analyses than benefits received and costs incurred by rich people. The idea here is to use differential weights to force commensurability. The obvious difficulty, one that has not yet been overcome in cost-benefit analysis, is determining the correct set of weights.

### **Alternatives to Cost-Benefit Analysis**

#### *Cost-Effectiveness Analysis*

Cost-effectiveness analysis can be used when all benefits and costs are measured quantitatively, but only some have been monetized. It is most typically and most readily used when all but one benefit has been monetized. For example, the cost of a government safety regulation may be known and the number of lives saved by the program may also be known, but there may be reluctance to attempt to monetize the value of the lives saved. Given these circumstances, the following ratio can be computed:

$$\text{cost/lives save} = \text{dollar cost per life saved}$$

To understand the role of cost-effectiveness analysis in evaluation, it is important to recognize a crucial distinction between it and a cost-benefit analysis of a program in which all impacts are monetized. The results of cost-benefit analysis will indicate whether or not the program produces a positive net gain and, hence, whether or not the program is worth undertaking. Cost-benefit analysis in which all impacts are monetized can also be used to rank several alternative programs. As previously discussed, the policy with the largest net gain would usually be ranked the highest. A cost-effectiveness analysis, in contrast, can only be used to rank several similar competing alternative programs against one another. The program with the lowest cost-effectiveness ratio (that is, with the lowest cost per unit of outcome) would be ranked the highest. Unlike a pure benefit-cost analysis, cost-effectiveness analysis cannot be used to determine whether a particular program should be undertaken because there is no way of knowing whether the program's net benefits are positive or negative. At best, all that can be determined is how the program compares with other similar programs.

As previously suggested, even if limited to ranking alternative programs, cost-effectiveness analysis is most useful if all impacts, but one, are monetized. For example, imagine two alternative safety regulations that save lives and also reduce the number of serious injuries and that neither of these outcomes is monetized.

One possibility is to compute two separate cost-effectiveness ratios – cost per life saved and cost per reduction in serious injury. The problem with this approach is that one regulation might rank highest in terms of one ratio and another might rank highest in terms of the other ratio. If so, then it is not clear how to choose between the two.

In using cost-effectiveness ratios to rank competing projects, they are subject to a problem similar to that discussed earlier in connection with benefit-cost ratios. Consider, for example, two alternative safety regulations: one saves 10 lives at a cost of €100 each, and the second saves 1, 000 lives at a cost of €100, 000 per life. Although the first alternative would rank highest in terms of its cost-effectiveness ratio, most persons would probably prefer the second alternative. Thus, cost-effectiveness ratios cannot be used mechanically to make decisions. As is usually the case with evaluations, careful judgment must be exercised. Nonetheless, they can provide information that is useful to the decision-making process.

### *Multi-Goal Analysis*

Multigoal analysis is a very general form of evaluation that can often be used when cost-benefit or cost-effectiveness analysis cannot be. Multigoal analysis is especially appropriate when two or more program alternatives are being compared in terms of how well they meet several different goals or objectives – for example, the relative extent to which they increase efficiency, the relative degree to which they reduce the inequalities in the income distribution, and how they compare in terms of political feasibility. If there are a number of goals, and the extent to which alternative programs meet some of these goals cannot be measured in monetary terms or otherwise be made commensurable, then cost-benefit or cost-effectiveness analysis may not be feasible; but multigoal analysis may be possible.

Multigoal analysis proceeds by simply listing each program alternative and then comparing them in terms of each goal – monetarily whenever possible; but if that is not possible, then quantitatively; and if that is not feasible, then qualitatively. The obvious limitation of multigoal analysis for decision making purposes is that unless one of the alternatives being considered dominates in terms of every goal, which is rarely the case, it is often difficult to draw a bottom line conclusion as to which is best. In contrast, benefit-cost analysis and cost-effectiveness analysis, at least in their purest forms, provide a single bottom line number. This is not a criticism of multigoal analysis, however. It simply recognizes that some programs have more than one goal, and the extent to which they attain these different goals cannot be measured in comparable units. Under such circumstances, obtaining a single bottom line number is not possible. However, by relying upon multigoal analysis, policymakers can use the information provided as an aid in formulating judgments as to the best decision.

## Conducting Evaluations

### *Impact Analysis*

As should be apparent, to conduct cost-benefit, cost-effectiveness, and multi-goal analyses, it is essential to have estimates of the impact of the evaluated programs. Obtaining quantitative measures of these impacts is usually referred to as “impact analysis.”

Even in the absence of further analysis, estimates of key program impacts, especially expected benefits, are of considerable interest in and of themselves. In particular, if there is evidence of negligible or even negative benefit (for example, a new football stadium would fail to increase attendance, a training program for the unemployed that results in little increases in the earnings of participants, industry regulation that does not stem pollution, or a new health policy that actually increases the number of deaths), then a cost-benefit or cost-effectiveness analysis is usually not needed. It is apparent that the program is unsuccessful without formally comparing benefits and costs.

Estimating program impacts almost always requires the use of counterfactuals. As previously discussed, an existing policy is typically compared to a proposed policy and impacts are measured as differences between the two. The term “internal validity” refers to whether this measured difference can be appropriately attributed to the evaluated program. This, in turn, depends on the way in which this comparison is made. The specific scheme that is used for a particular impact analysis is often called an “evaluation design.”

To understand impact analysis and internal validity, it is useful to examine several specific alternative evaluation designs in some detail. Diagrams representing five designs that are commonly used in evaluating public-sector programs that provide services to people (for example, health, criminal justice, public housing, training, and education programs) appear below:<sup>5</sup>

Design 1	$\begin{array}{c} \text{R: } 0_1 \quad \text{X } 0_2 \\ \text{R: } 0_3 \quad \quad 0_4 \end{array}$
Design 2	$\begin{array}{c} \text{R: } \quad \quad \text{X } 0_1 \\ \text{R: } \quad \quad \quad 0_2 \end{array}$
Design 3	$0_1 \quad \text{X } 0_2$
Design 4	$\frac{\text{X } 0_1}{0_2}$
Design 5	$\frac{0_1 \quad \text{X } 0_2}{0_3 \quad \quad 0_4}$

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<sup>5</sup> This method of diagramming evaluation designs was developed a number of years ago by Campbell and Stanley (1963).



In these diagrams, the symbol O represents an outcome measurement point, X represents a treatment point, and R indicates that random assignment was used to make assignments to treatment and control groups. These symbols will be further explained shortly.

The evaluation designs represented above are not the only ones that exist; there are numerous others. But the designs illustrated here provide a good sampling of the major possibilities. So that we can make our discussion as concrete as possible, we shall assume that all these diagrams pertain to alternative ways in which a government-funded training program for the unemployed might be evaluated. In this context, receiving the “treatment” means enrollment in the training program. Later, we shall discuss how these alternative designs pertain to evaluations of other sorts of programs. First, however, we examine, in turn, each of the evaluation designs that appear above.

**Design 1** represents a classical experimental design. The symbols indicate that unemployed persons are randomly allocated between a treatment group and a control (or comparison) group. Members of the treatment group can participate in the training program, being evaluated, while persons in the control group cannot. The way this might work in actual practice is that to test a particular type of training program the government would set up a “pilot program,” a small-scale replica of the proposed program. Pilot programs are also sometimes called “demonstration projects.” The idea is to see if the pilot program works before it is adopted on a widespread basis. An important issue in evaluations of pilot programs concerns their “external validity.” That is, the extent to which findings from the evaluation are valid in other places than those at which the demonstration was run and at other times. Thus, there is always some uncertainty in adopting a pilot program on a widespread basis, even if the results of the evaluation of the pilot program are very positive and confidence in their internal validity is high.

Once the pilot program is put into place, unemployed persons would be notified of its existence. Some of these persons would apply to participate in it. A computer would be used, in effect, to flip a fair coin: heads the applicant is selected as a member of the treatment group and, consequently, becomes eligible to participate in the program; tails the applicant becomes a member of the control group. Controls are not eligible to participate in the program, but can receive whatever other services are available for the unemployed. One way of looking at this is that controls represent the status quo situation; treatment group members represent the counterfactual. To measure the impact of the training program on (say) earnings, data on earnings would be collected for both the treatment group and the control group, both before the treatment is administered and afterwards. The earnings of the two groups would then be compared sometime after the training is completed.

The procedure just described for establishing treatment and control groups is called “random assignment.” The major advantage of random assignment is that there is a high probability of internal validity because the characteristics of people

in the treatment and control groups should be similar, varying only by chance alone. When random assignment is used to evaluate a pilot project that is testing a social program – for instance, a training program – this is called “social experimentation.” Although social experiments have been widely used in evaluating social programs in the United States, and used to some extent in Canada, Great Britain, and Western Europe, they have yet been used in Central and Eastern Europe.

**Design 2** is similar to Design 1 in that random assignment is also used to allocate individuals between the treatment and control groups, and both are referred to as “experimental designs.” The difference between the two designs is that the collection of pre-treatment baseline information on members of the treatment and control groups is not part of Design 2, but is part of Design 1. The problem with a failure to collect pre-treatment information is that there is no way of determining whether the treatment and control groups are similar or dissimilar.

For the comparison between the two groups to measure programs effects accurately (that is, to be internally valid), the groups should, of course, be as similar as possible. But, as previously mentioned, they could be dissimilar by chance alone, especially if each group only has a few hundred members, as is sometimes the case in social experiments. It is also possible that those running the experiment failed to implement the random assignment process correctly. If information is available on pre-treatment status – for example, on pre-treatment earnings – statistical adjustments can be made to increase the validity of the comparison between the treatment and the control groups.

**Design 3** is by far the weakest of the five designs, relying, as it does, on a simple before and after comparison of the same group of individuals. For example, the earnings of a group of individuals who went through a training program could be compared with what their earnings were before beginning training. The problem with doing this is that there is no information on what would have happened without the program. For example, the average earnings of people going into a training program could be very low if most of these people are unemployed at the time of entry. That, perhaps, is why they decided to go into the program to begin with. Even without the program, however, many of them might have found jobs eventually. If so, their average earnings would have gone up over time even if the program did not exist. With a before and after comparison, this increase in earnings would be incorrectly attributed to the program.

**Design 4** is based on a comparison of two different groups, one of which has gone through a program and the other of which has not. Membership of the two groups is not determined by random assignment, however. For example, in the case of a voluntary program, the comparison group could be made up of people in the program target group who decide not to participate. Because such a comparison group is not selected through random assignment, it is sometimes called a “quasi-control group.”

Unfortunately, with this design, there is no means of controlling for differences between the two groups that existed prior to the treatment. Perhaps, for example, at the time of application for training, those who ultimately went through the program had been unemployed for a longer period of time than persons in the comparison group, suggesting that in the absence of training they would have fared worst in the job market than members of the comparison group. But if at the end of training, it is observed that they actually did just as well as persons in the comparison group, this suggests the training had an impact: it pulled the trainees up even with the comparison group. With Design 4, however, there is no way to know of the difference in the length of unemployment prior to training. As a result, it would just be observed that after training members of the treatment group were doing no better than people in the comparison group. The absence of internal validity in this comparison could lead to the incorrect conclusion that the training made no difference.

**Design 5** utilizes both a treatment group and a comparison group. In addition, both pre-treatment and post-treatment data are collected. This provides information on how the treatment group differed from the comparison group prior to the training, which can be used in a statistical analysis to control for pre-treatment differences between the treatment and comparison groups. This is exactly the approach that was used several years ago in an evaluation of training programs in Hungary and Poland. This evaluation is described in Exhibit 1.

Because it is possible under Design 5 to take account of pre-treatment differences between treatment and comparison groups, it is usually superior to Designs 3 and 4. However, random assignment is not used to allocate individuals between the treatment and comparison groups. Consequently, as illustrated in Exhibit 1 in the context of Hungarian and Polish training programs, a threat to internal validity can occur if people in the treatment and the comparison groups differ from one another in ways that cannot be measured. Then, it becomes very difficult to adjust statistically for differences between the two groups. Perhaps, for example, unemployed persons who enter training are more motivated than unemployed persons who do not. If so, they might receive higher earnings even without the training. If the evaluators cannot somehow take account of this difference in motivation – in practice, sometimes they can, but more often they cannot – they may incorrectly conclude that higher post-training earnings received by the trainees is due to the training when, in fact, it is really due to greater motivation on the part of the trainees.

This sort of problem, which is sometimes called the “selection problem,” should be greatly reduced by using Design 1 or 2. The reason is that when random assignment is used, people assigned to the treatment group should not differ from members of the comparison group in terms of such characteristics as motivation, except by chance alone. However, although experimental designs offer the best protection against selection problems and, hence, the greatest assurance of internal

## EXHIBIT 1

### An Evaluation of Training Programs in Hungary and Poland

The governments in Hungary and Poland both provide skill retraining to the unemployed, paying stipends to those who participate that slightly exceed their unemployment benefits. Aided by researchers in Hungary and Poland, Christopher O'Leary (1997) estimated the impacts of these programs. (O'Leary also estimated the impacts of other active labor market policies in the two countries such as wage subsidies, public service employment, and assistance in becoming self-employed; but for brevity we focus here only on retraining.) Although the evaluation was limited to impacts, it was viewed as the first step in conducting a "comprehensive" benefit-cost analysis, which would include estimating reductions in unemployment compensation and unemployment assistance that result from retraining the unemployed (O'Leary, 1997, p. 25).

Work on the evaluation began by collecting data on program participants. Similar data were also collected on a comparison group of registered unemployed persons who did not participate in the active labor market programs provided by the government. In Hungary, a 10-percent sample of program participants was randomly drawn from all participants in 1996 in 10 of Hungary's 20 counties and the comparison group was randomly drawn from all non-participating registered unemployed persons in 1996 in the same 10 counties. In Poland, the sample of program participants was randomly drawn from program participants in 1995 in 8 of the country's 49 major administrative districts. Thus, the approach was similar to that used in Hungary. Unlike Hungary, however, a comparison group was constructed by selecting non-participants from among the registered unemployed in 1995 in these districts who had observed characteristics similar to those of the sample of program participants. Only pre-treatment characteristics were used for this purpose. The sampled individuals were interviewed in both countries in 1997. Staff of local labor offices in the 8 sample areas conducted the interviews during their off-work hours. Survey response rates were high in both countries, but especially in Poland.

As a result of the evaluation design, the treatment and program groups in Poland were similar in terms of the characteristics measured in the survey. Hence, outcomes for the two groups were directly compared, without further statistical adjustments. It was found that 61 percent of those who participated in training were employed sometime after leaving the program, while 49 percent of the non-participant comparison group was employed sometime after registering as unemployed. This 12 percentage point difference, the impact estimate, is highly statistically significant. Earnings on the most recent job among those who were employed were about 5 percent higher for the treatment group, on average, than for the comparison group.

Unlike Poland, the treatment and comparison groups in Hungary differed considerably from one another (for example, the treatment group was younger, more educated, and proportionally more female). Thus, a simple comparison of outcomes between these two groups is inappropriate. For this reason, O'Leary used various statistical methods (for example, regression analysis) to take account of differences between the two groups that existed prior to training. As discussed in the main text, doing this is important. For example, without the statistical adjustments, it was found that 56 percent of those who participated in group training and 62 percent of those who participated in individual training were employed after they left training, as compared to 54 percent of the comparison group differences of 2 and 9 percentage points, respectively. After the statistical adjustments were made, these differences increased to 9 and 11 percentage points, respectively. After making the necessary statistical adjustments, earnings upon reemployment were found to be nearly 10 percent higher, on average, for the treatment group (for both those who received group training and those who received individual training) than for the comparison group.

This evaluation raises an important question concerning internal validity. It attempted to ensure that the treatment and comparison groups in Poland were similar by drawing the latter from persons who had measurable characteristics that were similar to the former. In Hungary, in contrast, it was clear that treatment and comparison groups differed substantially. Thus, statistical methods were used to control for these differences. However, only characteristics measured in the survey (for example, age, education, and gender) could be used for matching in Poland and as statistical controls in Hungary. It was not possible in either case to take account of factors that could not be measured. Thus, the treatment and comparison groups could have differed in terms of such factors as motivation or ability. If they did, then failure to account for these differences could mean that the impact estimates reported above are not internally valid.

validity, a much larger number of evaluations have been conducted that have used a non-experimental design, such as Design 3, 4, or 5.

This brings up the obvious question of why, given their apparent advantage, experimental designs are not always used in conducting evaluations. The answer depends, in part, on whether an *ex ante* or *ex post* evaluation is being conducted. Experimental designs are almost always superior to alternative designs in *ex ante* evaluations of a newly proposed program that have impacts on individuals that can be tested on a pilot basis. However, sometimes pilot studies are impractical or inappropriate. To see this, think about an evaluation of a proposed new dam and consider how to set up a pilot project and use random assignment in conducting this evaluation. In fact, except for evaluations of programs that provide services to people, such as health and education programs, experimental designs are rarely used.<sup>6</sup> And even some service – type programs – for example, preventive medicine and crime prevention programs – have impacts that are better measured at the neighborhood – or community – level than at the individual – level and, therefore, can rarely be evaluated by using a random assignment approach.

Although experimental designs offer superior internal validity for *ex post* and *in medias res.* evaluations of existing service, non-experimental designs are sometimes superior in other important respects for conducting such studies. Consider, for example, an evaluation of a training or public health program that has existed for some time. Random assignment would mean that people who have traditionally received services under this program would now be denied them. There may be considerable political resistance to doing this. Moreover, as illustrated in Exhibit 1, non-experimental designs can sometime rely on data on persons who have already participated in the program and (in the case of Designs 4 and 5) persons who have not previously participated to obtain impact estimates.<sup>7</sup> Obtaining the information needed to conduct an evaluation that relies on an experimental design may, in contrast, require considerable delay and expense. First, a sample of families or individuals who are eligible to participate in the program must be randomly divided into a treatment and a comparison group. Data must then be collected on the two groups, ideally, both before the treatment group has participated in the program and perhaps several times afterwards. Finally, the data must be processed and analyzed. Policymakers may not want to wait until all this is completed to

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<sup>6</sup> An experimental design has been used, however, to test alternative pricing policies for electric power. See Aigner, 1985, for a summary of these experiments.

<sup>7</sup> Much of needed data on program participants (and sometimes non-participants as well) may be available in the records that many government agencies routinely maintain. If they are not, as was the case in the evaluation of Hungarian and Polish training programs described in Exhibit 1, then special surveys may have to be conducted. In addition, in conducting cost-benefit and cost-effectiveness analysis, the expenditure records of government agencies are almost always essential to construct cost estimates. Typically, however, the records of government agencies are not maintained in a form convenient for use in evaluation. In such instances, evaluators must typically devote considerable time to recording and reorganizing the information contained in agency records.

find out if a particular program works and, consequently, designs other than experimental ones may be used.

When an experimental design is inappropriate for evaluation, a non-experimental design must be used instead. Consider, for example, a city that is considering increasing the fees it charges to use its public transportation system, but is concerned that this will cause the use of the system to diminish considerably. To evaluate this change, it is obviously critical to determine how the higher fees affect the number of riders. Specifically, an estimate is needed of the price elasticity of demand for public transportation – that is, by how many percentage points ridership will change in response to a one-percentage point change in fees.

An obvious issue is how an estimate of this elasticity might be obtained.<sup>8</sup> It is difficult to see how the city could set up a randomized experiment because it only has one public transportation system. But it could, of course, raise prices for a few months and see what happens. This, in effect, would be a pilot project based upon Evaluation Design 3. One limitation of this approach, however, is that the city might not want to wait several months for an answer. Even in the absence of a pilot project, however, it is possible that public transportation fees in the city have gone up or down in the past. If so, it would be possible to examine how the number of riders changed during the period following the change in fees, an approach that again relies upon Design 3.

A potential problem with this approach is that during the period following the change in fees, the number of persons using public transportation may have also been affected by changes in circumstances other than the change in fees. For example, the city’s population may have been growing. This is exactly the sort of problem discussed previously in connection with Design 3. To make appropriate use of such comparisons, statistical techniques must be employed to disentangle the change in fees from whatever other changes occurred during the period under review. This disentangling can be facilitated by observing changes in ridership following several different changes in fees, perhaps, over a number of years. Such an evaluation design is usually referred to as an “interrupted time series.” Using  $F$  to represent the fee at different points in time and  $O$  to represent the number of riders during the period following each change in fees, this design can be diagrammatically represented as follows:

$$O_1 F_a O_2 F_b O_3 F_c O_4 F_d O_5 F_e O_6 \dots$$

An alternative approach is to examine cities similar to the one considering the change in transportation fees and try to determine the relationship between public

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<sup>8</sup> Rather than the evaluator having to estimate elasticity values needed for an evaluation, it is sometimes possible to obtain an existing estimate from the literature. There are many possible sources of literature for these purposes. These sources include books, journal articles, reports from think tanks, publications of interest groups, government publications, and the popular press.

transportation fees and ridership that exists among these cities. This design is really a variant of Design 4 and can be diagrammed as follows:

$$\begin{array}{c}
 F_a O_1 \\
 F_b O_2 \\
 F_c O_3 \\
 \dots \\
 \dots
 \end{array}$$

The evaluation design diagrammed above is usually referred to as a “cross-section.” Unfortunately, in using a cross-section, an evaluator confronts a problem similar the one we discussed earlier in connection with Design 4: these cities may differ in ways other than just public transportation fees and these other differences may also affect the use of their public transportation systems. For example, the cities could differ in population and in the quality of their public transportation systems. Again, it is possible to control for this to a degree through the use of statistics, but one can never be certain that these statistical adjustments are adequate.

It is also sometimes possible to combine time-series and cross-sectional data into a so-called “panel database.” An analysis based on panel data is often better than an analysis that relies solely on either time series data or cross-sectional data.

*Process Analysis*

Process analysis (which is also sometimes called implementation analysis) is needed whenever an ex post or in medias res. evaluation is being conducted of an existing program or a demonstration program.<sup>9</sup> Process analysis simply involves learning as much as possible about how a program that is being evaluated actually operates and the environment in which it operates. For example, in the case of an evaluation of a training program, a process analysis might involve learning about the bureaucracy set up to run the program, what sort of people receive the training, how long they remain in training, what sort of services they receive, what proportion of those enrolled in the program receive each service being provided, the economic environment the trainees will face when they complete the training, how decisions are made as to what sort of people receive what sort of services, and the availability of alternative training programs.

Depending upon the specific type of evaluation taking place, process analysis can have several different objectives:

1. A meaningful interpretation of findings from impact and cost-benefit analyses is only possible when something is known about the operational setting of the programs being evaluated.

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<sup>9</sup> For a recent discussion of implementation analysis, see Corbett and Lennon, 2002.

2. Process analysis can uncover various operational problems with a program that is being evaluated and suggest ways of correcting the problems. For example, perhaps those who can benefit most from a government training program are not those who are actually participating in the program. Thus, even in the absence of impact analysis or benefit-cost analysis, process analysis can sometimes help meet one objective of evaluation: improving the operation of existing programs.
3. To be able to list the likely impacts of a program, one must first understand in detail how it operates. Otherwise, some potentially important impacts may be overlooked.
4. If an impact or cost-benefit analysis appears to indicate that a program is effective, other areas may wish to adopt it. Process analysis can provide descriptive information about how the program was implemented and run so that it can be replicated elsewhere.
5. Sometimes programs result in unanticipated and, perhaps, undesirable side effects. For example, individuals and firms sometimes engage in anti-social activities to avoid government regulations. In evaluating regulations, it is critical that analysts be aware of such side effects. Process analysis can help evaluators detect side effects.
6. Comparison groups cannot be readily obtained or impacts cannot be quantified for some programs (for example, a community shelter for wives who are abused by their husbands). In such instances, impact analysis may not be feasible. Thus, process analysis may be the only evaluation tool available. In the case of a program that provides services, for example, process analysis could be used to assess whether the services are actually used and, from the perception of users, are viewed as desirable.
7. Sometimes programs are not implemented in the manner intended. For example, intended services may not actually be received. Indeed, they may not be needed or may be resisted by those at whom they are aimed. Similarly, regulations may not be effectively enforced. If so, it may be evident from the process analysis that the program being evaluated is not having the impacts anticipated and neither impact nor cost-benefit analysis may be necessary.

Depending on the type of program being evaluated and the specific objectives of the process analysis, a number of different methods and procedures can be used, often at the same time. The more prominent of these methods are briefly described below.

#### *Reviews of Existing Written Material*

A process analysis almost always involves a review of whatever written material already exists concerning a program that is being evaluated, including program descriptions, program operating rules, memos, reports, previous evaluations, and so-forth.



### *Management Information Systems*

Computer records are sometimes maintained by education, training, and health programs of the personal characteristics of each of the clients being served, the services received by each client, and the providers of the services. These records can be used to develop summary measures of client characteristics; the number of different types of clients receiving each of the various program services at a given point in time; or, somewhat more sophisticatedly, the flows of different types of clients into and out of the program and from one program service to another.

### *Interviews*

Interviews may be conducted of program staff or program clients. Interviews of program staff are particularly useful for determining the procedures they follow in serving clients or in enforcing regulations. Interviews of the clients of service programs are useful in determining whether they actually receive the services they are suppose to, their perceptions of the services, and whether they make use of the services. Interviews may be conducted either by telephone or in-person. If interviews with a number of different people cover similar ground, an interview guide or checklist is sometimes used. This guide may contain either close-ended or open-ended questions that are to be asked interview subjects or simply a list of topics that should be covered during each interview.

### *Focus Groups*

Focus groups, which involve discussions with small groups of clients that are led by a trained facilitator, are conducted for similar reasons as individual interviews of clients. However, they may be more efficient as responses can be simultaneously obtained from several clients. Moreover, points made by one client may stimulate reactions by others.

### *Surveys.*

Surveys are typically required for both process analysis and impact analysis. They are similar in certain respects to interviews, but typically a formal structured questionnaire or survey instrument is used. This instrument can be administered in-person, by telephone, or by mail; and the data collected may be either qualitative or quantitative in nature. Because the time given each interview is typically limited and the survey instrument is highly structured. Unlike interviews, most of the questions are likely to be close-ended and little opportunity to follow-up on points made by respondents will exist.

### *Participant and Nonparticipant Observers*

Observers can personally watch the operation of the program being evaluated. For example, in the case of an educational program for children, observers can be used to determine whether teaching occurs in the manner prescribed by the program. The difference between participant and nonparticipant observers is that the former has a role in running the program being evaluated or is a participant in the program,

while the latter is not directly involved in the program. One reason for using participant observers is that the staff running a program being evaluated may become guarded and change their behavior in the presence of a nonparticipant observer. The potential danger of using a participant observer is that such persons may feel that they have a vested interest in the evaluation producing positive findings.

### **Policy Utilization of Evaluations**

Are evaluations actually used in the policymaking process? In other words, are they worth undertaking? As one might guess, even in the United States, where evaluations are very commonplace, the role they play in decision-making is only very rarely definitive. However, they sometimes do have an important influence on policymaking, but they often do not.

The literature on how evaluations are utilized suggests that two sets of factors influence the extent to which findings from an evaluation are used. The first set of factors pertains to the characteristics of the policy environment into which results of an evaluation are inserted. As discussed below, Weiss's (1983) I – I – I (Ideology – Interests-Information) framework is valuable in understanding these factors. The second set of factors refers to key characteristics of the evaluation itself. Greenberg, Links, and Mandell (2003) suggest that these characteristics fall into one of the following five categories: (1) definitiveness, (2) communicability and visibility, (3) generalizability, (4) relevance, and (5) timeliness. The two sets of utilization factors are discussed next. As will be seen, to a limited degree, those conducting evaluations can increase the likelihood that their work will be used.

#### *The policy environment*

The central premise of Weiss's (1983) I – I – I (Ideology – Interests – Information) model is that "the policy positions taken by policy actors are the resultant of . . . the interplay of ideology, interests, and information. . ." (Weiss, 1983, p. 221). Ideology, as Weiss uses it, ". . . encompasses. . . principles, values, [and] political orientation. At its core are ethical and moral values" (p. 224). Weiss defines interests ". . . primarily in terms of self-interest" (p. 224). Information is descriptive in nature, defined as policy actors' ". . . sense of the current state of affairs, the relative seriousness of problems, [and] why things happen as they do. . ." (p. 225). Weiss points out that ideology and interests are typically only weakly affected by research findings, such as those from evaluations, if they are affected at all, and that research is only one of several competing sources of information used by policymakers. Other sources include direct experience, craft lore, media reports, formal and informal organizational channels, and interest groups.

An important hypothesis that Weiss (1983, p. 243) derives from the I – I – I framework is that the greater the internal consistency among ideologies, interests, and information from sources other than research, the less research results are utilized. In other words, Weiss's hypothesis predicts that evaluation findings are unlikely to have much influence on policy decisions if these decisions are otherwise

strongly determined by existing ideologies, self-interest, and information from competing sources. This suggests that evaluations are most usefully conducted when policymakers are receptive to the findings because their minds are not already made up on the basis of ideology, self-interest, or other information.

### *Definitiveness*

Definitiveness refers to the certainty associated with key findings from an evaluation. For example, whether policymakers view the findings as ambiguous; whether there is debate among researchers over the validity of the findings; and whether the findings corroborate or contradict other information sources or the intuition, values, and expectation of policymakers. For example, in the case of random assignment experiments, one would anticipate that, if random assignment is carefully implemented and monitored and the evaluation is done well, the results would be accepted as relatively definitive. Indeed, John Ziman, a physicist, has suggested that “a good experiment is a powerful piece of rhetoric; it has the ability to persuade the most obdurate and skeptical mind to accept a new idea.” (quoted by Majone, 1989, pp. 30 – 31).

### *Communicability and visibility*

It seems self-evident that the more aware decision-makers are of evaluation findings and the better they understand them, the greater the likelihood of the research being utilized. Findings from an evaluation that does not use highly technical statistical methods is more easily communicated than one that does, and a large and expensive evaluation is more likely to be visible than a small one. Communication and visibility can be further enhanced by dissemination efforts on the part of those funded and conducting an evaluation.

### *Generalizability*

Generalizability refers to whether evaluation findings can be applied to different time periods or places or to programs or policies that differ somewhat from those evaluated – that is, their external validity. The more generalizable a particular piece of research is, everything else equal, the more likely it is to be used. No evaluations are perfectly generalizable, but some are more generalizable than others. Findings from an evaluation of a training programs that were obtained in places where or at times when unemployment was high may not be entirely applicable to places where or times when unemployment is low. For example, the evaluation of training programs in Hungary that is described in the Exhibit 1 appearing above was conducted in the mid-1990s, when unemployment was much higher in that country than is currently the case. Thus, the current impacts of training may differ from those obtained from the study.

### *Relevance*

Relevance concerns whether the needs of decision-makers are met by an evaluation. If the research meets decision-makers’ needs, they are obviously more likely to use

it. As discussed next, one can assess whether an evaluation that will take a short-period of time will be relevant, but there is no way to know in advance whether policymakers will view an evaluation that will require several years as relevant.

*Timeliness*

Evaluation findings are most likely to be used if they become available when the decisions to which they are relevant are being made. Many of the types of evaluations discussed above can be done fairly quickly, in a year or less. However, relative to other research, social experiments would appear to be at a particular disadvantage regarding timeliness. By the time an experiment is designed and implemented, the treatment administered, and the data analysed, several years can easily transpire. Based on a series of case studies of social experiments conducted in the United States, Greenberg, Linksz, and Mandell (2003) conclude that timeliness is the most important of the five-utilization characteristics and that a lack of timeliness is the factor most likely to impede the utilization of evaluation findings.

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# Chapter 10





# Budgeting as Policy Process

*Mihaly Hogue*

## Features and Functions of a Public Budget

A significant development in the intellectual history of the 20th century has been the explicit recognition by economists, politicians, and the public at large of the importance of government in the operation of the economy. The national or government budget<sup>1</sup> generally reflects the policy of the government toward the economy. *Government budget is a forecast of governmental expenditures and revenues for the ensuing fiscal year, which may or may not correspond to the calendar year.* Except for primitive economies, the budget is the key instrument for the expression and execution of government economic policy. Government budgets<sup>2</sup> have wide implications for the national economy. By budgets governments exercise their allocative, stabilization and distributive functions. They are, therefore, *political as well as economic documents and are products of the political processes* by which competing interests in any nation achieve agreement.

Although the major *budgetary decisions* that affect the performance of the economy and the national debt are usually made by the *central government*, most countries have *local or state (provincial) governments*. These are responsible for the provision of various services and have the authority to raise revenues through taxation or to borrow on their own account. This devolution of authority is greatest in the United States, where the majority of provision of civilian services is carried out at state or local levels and where states have a tradition of being individual decision-making units. In the United Kingdom, by contrast, local-authority spending is constrained by rules set by the central government. Local authorities are also limited in their ability to borrow and to raise taxes, which are set by the central government. The budget of the European Community is an example where authority for major spending, particularly for agricultural support, has devolved to a transnational body.

Government or public budgeting is highly political: it determines whose policy preferences prevail. Decisions on whether to raise or lower taxes or expenditures, to build bombers or provide health care for the poor, and to hire police or social

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<sup>1</sup> A distinction should be made between a budget and a budget system. Whereas the budget refers only to the documents within which financial proposals are contained, the budget system refers to the relationship between the stages to be followed in order to compile the budget documents.

<sup>2</sup> There are various practical approaches to budgeting, including the administrative budget, which emphasizes the expenditures of ongoing government operations; the capital budget, which gives separate treatment to public-works projects and their special financing requirements; the cash budget, which simplifies budgetary procedures; the full-employment budget, which projects expenditures and revenues to produce surpluses or deficits in order, according to the Keynesian theory, to produce full employment; and the program budget, which classifies expenditures according to the items on which they will be spent.

workers are all public budget decisions, as is any other public sector decision about the collecting or spending of money.

The *difficulty* of discussing *budgeting as a political process* lies basically in the difference between discussing private sector companies or individuals and government budgeting. Although the process of preparing and discussing a national budget has progressed considerably during the 20th century, it is in a number of senses still inferior to the way budgeting is carried out by private sector companies or indeed by individuals. Commercial practice is governed by a series of well-defined rules, and firms are required to produce a balance sheet, a profit and loss account, and to monitor their cash flow carefully. The total indebtedness of a company is monitored closely by its shareholders, who are also sit in judgment of future forecasts of profits and growth. Individuals who fail to budget adequately are equally closely monitored by bank managers and credit agencies, and those with complicated affairs can draw upon skilled professional help.

The *accountability of government*, even in a well-developed democracy, is in reality considerably less acute, or certainly less clear, than that of companies to their shareholders or individuals to their various creditors. As a result, governmental budgeting is frequently of lower quality than is the norm in the private sector. Forecasts of receipts and expenditures are often wildly at variance with reality; changes to accounting practices are sometimes made for cosmetic political purposes; and certain distinctions, such as those between capital and current expenditures, are frequently blurred deliberately. These criticisms of the national budgetary process are more valid in some countries than in others.

According to Aronson and Schwartz (1981) the extent of the budget amounts and the operating programs on which they are based is the dividing line between the private and the public sectors. The budget stipulates which goods and services are to be supplied to the public by the authorities and which are to be supplied by the private sector. The decision on who is to supply what and who is to receive what should be a reflection of the community's values, preferences and priorities. Therefore, the budget is a political document through which money is appropriated according to value judgments and the budget process is a political process that takes place within a political arena. (Gildenhuys, 1997)

The most important features of a public budget are:

- The budget, after its approval by the legislative authority, is *enforceable*.
- The *results* of most of the objectives to be realized by the budget are not *quantifiable*.
- The budget brings together a *variety of considerations*.
- As the objectives of action taken by public institution differ widely from those of private organizations, the processes for determining the content of a public budget are therefore *unique*.
- Authorities do not always adapt their *expenditure* to fit their available *revenue*.

It may therefore be stated that a public budget is an instrument at the disposal of the legislative authority. It enables the legislative authority to guide the economic, social, political and other activities of a community in a certain direction in order to realize predetermined goals and objectives, the results of which are not always quantifiable. The budget also contains all of the measures needed to subordinate the executive authority to the legislative authority as the representative of the voters and taxpayers. The features of a public budget ensure the unique foundation on which its preparation, approval and execution are based. In public administration the budget serves as a decision-making instrument by which priorities are set, goals and objective are established, operating programs is compiled, and control exercised. A budget document is the final product in the budget process and it should be suitable for consideration and approval by the legislative authority, while the execution of its contents should realize public objectives. The quality of the budget depends on the accuracy of the supporting data, the quality of the methods used and the expertise as well as the integrity with which it has been compiled. As a result of the broad spectrum of services that an authority has to render, however, budgets can offer only a synoptic picture of their financial implications. Therefore, a compromise has to be made in the budget document between the requirements for adequate, accurate information and for manageability.

Gildenhuis (1997) views the functions of the pubic budget as follows:

- The budget is a policy statement declaring the goals and specific objectives an authority wishes to achieve by means of the expenditure concerned. It is public policy expressed in amounts of money and is the actual embodiment of policy and of implied policy objective. In policy making, realization of the most important objectives and aims should receive priority. As a policy-making document, the budget generally contains a definition of both the quantity and the quality of the envisaged service delivery. However, no normative guidelines exist by which priorities may be scientifically determined, thus that is the result of political expedience.
- The redistribution of wealth is one of the most important functions of a public budget. It requires that total integration should exist between the two sides of the budget – revenue policy (taxation) and expenditure policy – in order to comply with a fiscal policy for the redistribution of wealth.
- The public budget is an important stabilizing instrument that may be utilized to combat fluctuations within the economy. It comprises the use of tax authority and public expenditure authority, and this makes the budget all the more important as an economic regulatory instrument.
- For the administrative authority, the budget is a macro work program on which each department can base its own operational work program. This function of the budget demands that the structure of objectives, the activity schedule, the resource schedule, and the financial schedule is clearly expounded in the budget documents.

- The budget serves as a source of information for everyone concerned, and the information contained in the draft budget document is necessary for its consideration and, after approval, serves as the most important source of information to the administrative authority for executing its functions.
- The budget also serves as a co-coordinating instrument by which all government activities can be integrated, because it is supposed to contain all the information on the policies, objectives and activities of the government in one document.
- The budget is also a control instrument to be used by the legislative authority over the executive authority and by the executive authority over the administrative authority and even for internal control within a single component of the administrative authority. Two types of administration control are important in this regard, namely, *a priori* control and *ex post* control.

### Evolution of a theory?

The applicability of the word “*theory*” in this area is a far cry from its usage in the social sciences, particularly in economics. This has been explicitly recognized by the quasi patron saint in the field, Wildavsky, who said: “. . . a normative theory of budgeting would be a comprehensive and specific political theory detailing what the government’s action ought to be at a particular time. Given that the budget represents the outcome of political struggle, a normative theory of budgeting suggests the elimination of any such conflict over the government’s role in society. Such a theory, therefore, is utopian in the fullest sense of the word: Its creation and acceptance would mean the end of politics.”<sup>3</sup>

Theorizing about budgeting and policy-making encompasses a myriad of different elements:

- prescriptions ranging from modest technical ones on accounting principles or expenditure classification, to quasi-philosophic ones on accountability,
- hypotheses about what political purposes the budget process serves, for instance by providing a forum for reconciling at the margin irreconcilable differences in values and priorities among elected decision-makers,
- descriptions and analyses of how national systems and international norms have evolved, with each reform proposal being engendered by the disappointments left behind by the preceding one. (Lacasse, 1996)

Much of the literature on budgeting emanates from the United States, where in the 1960’s “incrementalism” became the dominant theory of budgeting. *Incrementalism* is a style of policy-making based on small, marginal changes from existing policies. It contends not only that comprehensive rationality<sup>4</sup> is impossible, but also that policies are seldom changed radically as a result of extensive reviews. It is a tendency of government to tinker with policies rather than to question

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<sup>3</sup> Wildavsky – Caiden, 1997, p. 265.

<sup>4</sup> Comprehensive rationality is a style of policy-making based on scientific assessment of alternative actions and conscious choice of the course of action that will yield the maximum benefit. It suggests that policies are subjected to a multi-step analysis before a decision is made.

the value of continuing them. Considering the work of Wildavsky (1964), Fenno (1966) and others, budget processes were seen as stable, predictable, changing little from year to year, and based on well defined roles that could be represented by relatively simple decision rules. They argue that a process which concentrates on an increment is preferable to one that attempts to review the whole budget because it moderates conflict, reduces search costs, stabilizes budgetary roles and expectations, and reduces the amount of time that officials must invest in budgeting, thereby increasing the likelihood that important political values will be taken into account. The term incrementalism promises budgetary growth with most of the program and expenditure increases. Statistical analysis of incremental outcomes typically measures the amounts and rates of increase. Descriptive studies concentrate on the tactics used to augment the basic budget in “small steps”. However, incrementalism offers little explanation as to how decisions are made or how the increment is divided (Schick, 1986).

By the late 1970's incrementalism was seriously challenged as a theory of budgeting (LeLoup, 1978) because of the narrowness of its analytical focus and changes in the environment and processes of budgeting. “When a theory applies to all situations at all times without the possibility of disconfirming evidence, it is no longer a theory and of little use for explanation or even description.”<sup>5</sup>

As economic and social intervention by governments has increased, the limitations of incrementalism as a budgeting practice have become increasingly apparent. A number of techniques or attempts to reforming budget systems have been introduced to make decisions more rational.

Evolution of budget theory and policy-making over the last decades shows that undeniable progress has been achieved, often on modest fronts and with reasonably simple techniques. A key development in budget theory in recent years has been the differentiation between *microbudgeting* and *macrobudgeting* and the inherent tension between them. “Macrobudgeting – high level decisions on spending, revenue and deficit aggregates and relative budget share, often made from top to down. Microbudgeting – intermediate level decisions on agencies, programs, and line-items, usually made from the bottom up.”<sup>6</sup> Macrobudgeting refers to general efforts to study and theorizes about budgetary outcomes on a comparative basis including several countries. It is synonymous with stabilization policy and the Keynesian – Monetarist debate, including the debate about deficits. Microbudgeting refers to studies focused more on the internal dynamics and processes of budgeting between departments and agencies, as well as such activities as auditing, tax collection and user fees. Both levels of analysis are interested in how power is structured in budgetary processes as well as being exercised and expressed through budgetary choices.

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<sup>5</sup> LeLoup, 1978, p. 502.

<sup>6</sup> LeLoup, 1988, p. 19.

In terms of the evolution of budget practice, a number of developments in legislation in the 1980s have fostered a movement towards macrobudgeting. Several key trends can be identified:

- Reconciliation has been institutionalized
- The budget committees and party leaders are more powerful
- Budget-related legislation is increasingly “packaged” together
- Relations between the executive and the legislative centers have evolved to negotiating budget aggregates.

In the United States, for example, unlike Congress, which avoided direct decisions on budget aggregates until the 1970s, the President has been concerned with totals since the passage of the Budget and Accounting Act of 1921. Yet presidential budgeting remained largely a bottom-up process (difficulties in solving macroeconomic and macrobudgetary problems with a system oriented primarily to microbudgeting). As with the Congress, executive branch budgeting went through dramatic changes in the 1980s: agency budget practices were replaced with a top-down process.<sup>7</sup> Even as top-down budgeting, as practiced in the first two years of the Reagan Administration, faded, macrobudgeting did not. The defense budget process in the 1980s reflects the shift from micro to macro-level concerns. (LeLoup, 1988) As a final conclusion: “The basic conceptualization of budgeting has shifted from a cycle of micro-level, incremental executive requests and legislative actions to a complex series of political responses to short-term economic changes and projections of relatively inflexible long-term trends in outlays and revenues. Key questions now concern how to balance micro decisions within macro-level parameters. No grand theory of budgeting has emerged, but we are closer to explaining the budgetary process. . .”<sup>8</sup>

### **Budgetary process and political actors**

The budget process has four general stages, which are given various names: (Reed and Swain, 1997)

1. Preparation or formulation
2. Submission and approval, policy making, legal enactment, or formal approval
3. Implementation or execution
4. Audit and review, audit, audit and evaluation, or review.

Politics are especially evident in the first two stages of the process but implementation and audit are also penetrated by policy issues. The preparation of budget is usually the responsibility of executive powers, of the government and its offices (ministries, departments), including in most countries the budget office. The operat-

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<sup>7</sup> Top down budgeting means that budgeting is centralized in the executive branch, the legislative branch or both. An individual, a committee or an office is responsible for setting overall targets and evaluating requests in light of these targets.

Bottom up means that there is no prior central policy control over the budget. Budgets are created as the aggregates of individual requests from agencies and from committees.

<sup>8</sup> LeLoup, 1988, p. 36.

ing agencies (line ministries) are proponents of spending, and the central officials (budget office, ministry of finance) are proponents of economizing and of care in the selection of spending choices. The second stage of the budgetary process begins when the chief executive or administrative officer submits a proposed budget to the policy-making or legislative body. Policy makers look at the information in the proposed budget<sup>9</sup> as another proposed policy or law. The process is one of gathering information, looking at alternatives, and voting on preferred policies. This stage concludes when the proposed budget with any changes is approved as a policy or policies, or as a law or laws that provide authorizations to operating officials to collect and spend money.<sup>10</sup> (Reed and Swain, 1997)

Hagen and Harden (1996) have developed a model for budget process that is described in the following pages. According to them budget cycles can be analyzed and sequences of four stages:

1. A planning process in government (the government stage) culminating in the submission of a draft budget law to parliament;
2. A parliamentary stage, ending with a formal budget act;
3. An implementation stage during which the budget act is put into effect and revisions may occur; and
4. An ex post control stage.

At any particular point in time, different stages of at least two, often three, successive budgets will have been reached. This is illustrated in Table 10-1. During year *t*, the current budget is in the implementation stage, next year's budget in the government or the parliamentary stage, and the previous year's budget is being

<sup>9</sup> In the United States, where budgeting largely takes place in the legislative arena, the legislative branch produces its own information, too. Executive budgeting means that the chief executive and his/her staff have responsibility for putting together a budget proposal and presenting it to the legislature for approval. Legislative budgeting means that the agencies make their proposals for spending directly to the legislature, without being evaluated first by the executive.

<sup>10</sup> In the United States the federal budget is the responsibility of the president and is prepared by his Office of Management and Budget. Traditionally the U.S. budget deals mainly with expenditure programs and revenues are covered only briefly. The size of the expected budget deficit or surplus is regarded as very important, particularly in its potential effect on interest rates, employment, and other factors. An important aspect of the budgetary process is the greater influence of the Congress compared with British and European legislatures. The U.S. budget is submitted in January for the fiscal year commencing in July. It is then considered in great detail by several subcommittees of the House of Representatives and to a limited degree by the Appropriations Committee of the Senate. Minor amendments to the budget are quite common, but the influence of the Congress is more significant than the amendments suggest, for often Congress has greatly influenced the scope of the budget while it was being prepared.

In Great Britain the preparation of the budget is the function of the Treasury, which is headed by the chancellor of the Exchequer. It is presented to the Parliament by the chancellor, usually in the spring. Limited discussion of the budget takes place in Cabinet meetings while it is being prepared, but final details may be withheld from the full Cabinet until the budget day. The emphasis of the British budget is on taxation and the state of the economy. Estimates of expenditures in detail are published separately, either on the same day as the budget or a few weeks in advance. Parliamentary committees discuss and criticize expenditure estimates but do not have the power to amend the budget.

subject to an accountability process. Multi-year frameworks for budget preparation and lengthy accounting and discharge procedures may create even more overlap.

**Table 10-1**  
Stages of the Budget Process

Government and Parliamentary Stage	Implementation	Ex post control		
	Government and Parliamentary Stage	Implementation	Ex post control	
		Government and Parliamentary Stage	Implementation	Ex post control
year t-2	year t-1	year t	year t+1	year t+2

In EU countries, the government stage usually begins 11 or 12 months before the start of the financial year; the parliamentary stage commonly covers the last 3 to 4 months before the beginning of the budget year and concludes just before it. The government stage is normally conducted exclusively within the executive branch of government. Within the executive branch, the ministry of finance is involved, with various degrees of authority, in the organization of all steps of the government stage. In some countries, this function is spread over different ministries.

The parliamentary stage comprises the bargaining process between the government and the legislature over the budget law. All parliaments of EU member states considered here have rules of procedure for the budget law that are different from the procedures for ordinary laws. These special procedures are intended to assure that the budget law is passed in time, that is, before the beginning of the next financial year, by limiting parliamentary debate and, in some cases, allowing the executive to speed up the process. Parliament generally has the power to reject the budget entirely and to amend parts of it.

The implementation of the budget during the financial year is again primarily the responsibility of the executive branch of government. Parliament may be involved in this stage, particularly in approving supplementary appropriations.



Table 10-2 lays out the basic structure of a budget process. Step G1 begins with the formulation of budget guidelines and norms. It includes the circulation of purely technical guidelines to be followed in the drafting process, as well as the presentation of the main assumptions about macro economic trends and developments for the year under consideration to all ministries concerned. In addition, this step may include the determination of important targets for the budget under consideration, for example, for total expenditures or the total deficit.

**Table 10-2**  
Main Steps of Budget Process

<b>Step</b>	<b>Action</b>
<b><i>Government Stage</i></b>	
G1	Formulation of budget targets and guidelines
G2	Preparation of budget bids
G3	Compilation of budget draft
G4	Reconciliation
G5	Finalization of budget proposal
<b><i>Parliamentary Stage</i></b>	
P1	Debate, amendment of, and vote on budget proposal
P2	Reconciliation between upper and lower houses
P3	Approval by government
<b><i>Implementation and Revision</i></b>	
I1	Execution of the budget act
I2	In-year changes of the budget
<b><i>Ex-post Control and Accountability</i></b>	

Step G2 contains the preparation of the individual budget bids by the spending departments. It commonly evolves within the spending ministries on the basis of the budget guidelines and targets determined in the first step. Spending ministries must formulate priorities and justifications for their bids and develop defense strategies against the finance minister's efforts to reduce bids and against competing bids by other spending departments. Spending ministries may communicate with the finance ministry during this step, but rarely do spending ministries communicate with other ministries on a formal basis.

Step G3 includes the compilation of the first draft of the budget, commonly a responsibility of the finance ministry. It may also include rounds of bilateral negotiations between the spending ministries and the finance ministry. The drafting of the revenue budget is commonly the responsibility of the finance ministry.

Step G4 consists of attempts to reconcile conflicts arising between the finance ministry and the spending ministries and between different spending departments.

Reconciliation involves either only the prime minister acting as an arbiter among the spending ministers, or a selected cabinet committee, or the entire cabinet. Step G5 ends this stage with the final approval of the budget draft in cabinet, after which the draft bill is handed over to the parliament.

The structure of the budget decision in parliament (P1) depends heavily on the country's constitutional framework. In bicameral parliaments, budget processes differ significantly in the way budgetary powers are shared between upper and the lower houses.

In most European countries, an outright rejection of the budget is politically equivalent to the government's losing a vote of confidence and will lead to the resignation of the government. This is reflected by the practice that the first reading of the budget is often a debate over the government's general policies followed by a first vote on the budget draft. The budget itself is then treated in detail in the subsequent readings, when amendments can be received and passed. The budget becomes law at step P1 or P2.

Once the budget act has become law, the budget process enters the implementation stage. Since implementation is primarily a responsibility of the government, the principal actors here are again the spending ministries and the finance ministry, although outside bodies such as audit institutions may be involved. Implementation may overlap with the planning stages of the process in government and parliament. Overlap also comes from the possibility of revising the budget during the relevant fiscal year by proposing, and passing through parliament, supplementary budgets. Supplementary budgets are commonly subject to the same steps as ordinary budgets.

One can recognize that in the budgetary process, the relationship between the budget office and the political centre(s), that is the government and the parliament or congress, may be more important and significant than the relationship between executive and legislative bodies. In many countries the relationship between budgeting and policy-making focuses on the need to ensure the coherence of government action through two quite distinct central institutions, namely, the budget office and the policy-making centre of government.

Lacasse (1996) emphasizes the need for clear institutional distinctions between the policy-making centre and the budget office, given the diversity of government's obligations. Achieving *harmonization* and *complementarities* between the two does not entail merging their viewpoints, but rather, harnessing their differences.

What are these differences? On the one hand, budget office cultures are quite strong; the organizations are small and tightly knit and the work load is heavy and calendar-driven. Its assigned duties are: manage the budget process, guard the public purse, and handle financial markets and the financial reputation of the government. The policy centre, on the other hand, is where the demands for policy changes emanating from line departments (ministries), the citizens, pressure groups and

the external environment have to be reacted to and decided upon, where policy responses have to be given, and sometimes initiated.

Stability, clarity and carefully planned changes constitute key values for the budget office. Apart from the central functions, the office is a reflection of the division of labor within government. As guardian of the purse, it is tasked with managing the fiscal position, with taking care of particular “clients”, as is the case of any line ministry. When their requests are not incorporated into the budget cycle, which is built-up with hard-won compromises, the budget office has little flexibility.

The basic inputs for the centre are political problems that sometimes form crises and discontent. Central government functions require stability, rigor, on the one hand, and responsiveness, innovation, flexibility, on the other. “. . . An absolutely clear-cut division of labor is impossible. For better or worse, budgeting is inherently policy-making and, conversely, serious policy formulation cannot be done without addressing resource implications that is, budgeting.”<sup>11</sup> There is a great deal of consensus on the essential features of rules and systems aimed at guaranteeing *harmonization* and efficient *complementarities* of action. These relations between the budget office and the centre are a basic issue, that quality budgeting depends on orderly policy-making and, conversely, that enlightened policy-making requires quality budgeting as a key input. The principles are clear and simple, but their implementation is an unending process of adaptation and improvement.

The third dimension to the budgeting and policy-making interface is *co-responsibility*. The centre and the budget office are the two basic coherence institutions of government. They control the government’s two key instruments: the legislative stream and the budget process. These institutions are the only ones where competing claims are reconciled, and where an overall perspective on the evolution of the state can be developed and implemented.

The two central coherence institutions must be equipped to confront and deal with problems falling outside the responsibility of the line ministries. The danger here is that even when harmonization and complementarities are correctly managed on a daily basis, important questions will remain undetected until costly crises erupt, simply because the two central institutions are not structured to handle issues that fall outside the purview of line ministries and of each of the central institutions individually.

### **Rules and norms for government budgeting**

The recent experience of budgeting and policy-making has left behind a substantial body of rules, norms and practices, which are routinely applied or pursued in most countries, because they are widely recognized as workable and reasonably efficient and are required by international organizations and/or financial markets. Budget norms are much easier to identify than policy-making ones. They are explicitly

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<sup>11</sup> Lacasse, 1996, p. 37.

formulated; their compliance or non-compliance is easily observable and often sanctioned by financial markets.

The new budget reform techniques are consistent with the classical principles for appraising budgets.<sup>12</sup>

1. *Comprehensiveness*. The budget should include all receipts and outlays of the government. The single process would thus include all activities of the government.
2. *Unity*. All spending and revenue-collecting parts should be related to each other. Consistent evaluation criteria should be applied to any expenditure, regardless of the government area in which it is located.
3. *Exclusiveness*. Only financial matters should be in the budget. (Modern analysts recognize, however, that almost every governmental action has financial implications.)
4. *Specification*. The budget should be executed as it is enacted. Cavalier changes should not be made during the budget year.
5. *Annuality*. The budget should be prepared every year for the next year of agency existence.
6. *Accuracy*. Forecasts should be as reasonable as possible and the document should be internally consistent.
7. *Clarity*. The budget should describe what is proposed in understandable fashion. The document, in an effort to encompass all, should not bury policy intent in line-item detail.
8. *Publicity*. The budget in a representative democracy should not be secret. The budget contains the expenditure plan (as well as the revenue estimates) of the government. It is clearly contrary to the underlying principles of a democracy that such important choices are made without complete public consideration.

According to Lacasse (1996) the three most important budget related rules are: *comprehensiveness* and a *multi-year perspective* in budget elaboration, and the capability for *monitoring implementation* so as to further *accountability* and timely adjustments. (The latter two partly correspond with specification, clarity, and publicity.) These issues in budget office-centre relations all fall under the three categories of harmonization, complementarities and co-responsibility, as discussed above.

On the other hand, Wildavsky and Caiden (1997) argue that to understand what was happened to budgeting in our time consider the *radical changes in the norms* of desirable behavior that previously guided budgeters. According to them budgets emerged at the beginning of the nineteenth century as the result of reforms that replaced centuries of muddle and mismanagement with expenditure control based on *norms of annularity, comprehensiveness, legislative appropriation, audit, and balance*. Government budgets today are evaluated against their *long-term implications*, they consist of many different kinds of spending, and they are *unbalanced, uncertain, and dependent on circumstances beyond their control*.

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<sup>12</sup> Howard, 1973, pp. 5 – 8. Quoted by J. Mikesell, 1991, p. 121.

As far as the norm of *comprehensiveness* is concerned, the rule could be re-written as: every penny whose allocation is made via the political process, not the market, should be recorded and presented for assessment in the budget. Very little dispute has arisen around this rule at the theoretical level; however, in practice this is a much more demanding rule. This rule has been broken by direct loans, loan guarantees, tax preferences, off-budget corporations, open-ended entitlements and other devices. (Wildavsky and Caiden, 1997)

For instance, over the last two decades, the reintegration of special funds into a “normal” budgetary perspective has been one of the biggest changes in implementing this rule. There is also an increasing tendency to treat commercial activities carried by ministries and state enterprises for what they are – in other words, the distinctions between commercial and public policy functions have been sharpened. (Privatization has helped on this front.)

Other categories like tax expenditures, guaranties and regulations are not likely to be overcome soon. Implicit guaranties, such as unfunded pension obligations, to the banking and financial system institutions remain outside the budgetary purview. It is not even clear how they could be included. Also, debate is still going on the very legitimacy of the concept of tax expenditures. The attempts to design and use a regulatory budget have also failed. On the other hand, one can argue that tidying these “loose ends” up might increase the complexity of the budget to such a degree, that it could defeat its very objective of improving transparency and accountability. (Lacasse, 1996)

Conflicts about policy instruments involving some form or other of off-budgeting are likely to arise among the budget office, the policy centre and the line ministries. The latter (and their clients) want as much autonomy as possible, preferably with sole control of their “own” revenues. Policy-makers sometimes refer to the symbolic value of institutions that can be described as “new, dynamic, and outside-the-clutches-of-bureaucracy”, or presented as “your-very-own” to powerful interest groups. Off-budgeting expenditures are used against budget cuts. It is a time-honored strategy when electorates are sensitive about the deficit.

The issue between budgeting and policy-making is more than a straight-forward problem of disharmony. The key to the solution – that is to the continuation of the last decades’ evolution towards really comprehensive budgets – probably lies in rigorous budgetary laws and rules.

Apart from the temptations to go off budget, the other important issues seem linked to the choices between regulations and expenditures or between direct expenditures and tax expenditures. Budgeting of tax expenditures, even in a primitive fashion, is rare, while regulatory budgeting has not traveled far from the textbooks and amounts to little more than good intentions. From policy-making view, such issues of central responsibility seem to have trouble finding an institutional home. The key issue here is the capacity of both sources of coherence to act jointly. (Lacasse, 1996)

The chronological counterpart of the comprehensiveness rule is the *annuality* versus *multi-year budgeting*. The latter is intended to *reconcile the annual budget with multi-year policy commitments*. This apparently contradictory injunction is important in two respects: for new or reformed policies, and for the cross-impacts of policies. In both cases, the elaboration of the current budget demands accurate cost forecasts. Viewed from the decision-making centre, this rule, which is just as consensual as the comprehensiveness one, means that the centre is entitled to obtain from the budget office well-grounded assurances that the resource consequences of today's decisions have been calculated as precisely as possible.

An adequate multi-year costing of new proposals will routinely create conflicts between all central agencies and line ministries, and very often between the budget office and the centre. Moreover, solutions adopted with success in some countries will tend to be resisted because they slow things down, irritate politicians and will be considered in breach of ministerial responsibility. Furthermore, these solutions increase the difficulties in dealing with pressure groups.

The consensus over the fact that the budget office is a key instrument of control and should play an important role in supplying implementation feedback, indeed, in *controlling implementation*, is as strong as it is traditional and vague. This somewhat paradoxical situation has a variety of sources. First, institutions vary markedly between countries. Second, the very content of "implementation feedback" is a mixed-bag, ranging from compliance and integrity controls to impact evaluations. Third, basic strategies as to who should be responsible for providing such feedback to whom also vary from country to country, and substantial overlap in responsibilities exists between institutions within countries. And, fourth, in contrast to the monopoly position of the budget office and the centre in elaborating the budget and controlling the legislative and regulatory streams, implementation involves the intervention, sometimes decisive, of other players: internal auditors and evaluators in some countries, courts of audit reporting to the legislature in most countries, and ad hoc or specialized bodies, ranging from commissions of inquiry to bodies of auditors and evaluators, with expertise in fields such as social policy or the control of financial institutions.

It is assumed that the implementation of the budget routinely and rapidly generates information as to whether the monies voted are indeed being spent within the legislated framework provided by the budget. Such implementation monitoring exists in most countries, but this basic feedback on policy implementation is often limited to financial information and is used almost exclusively by the budget office. This is rarely felt to be enough by the centre, whose attention is obviously oriented towards the future, towards new policies or revised ones. (Lacasse, 1996) This is the reason why analysts state that the *control of spending* has declined along with the norm of comprehensiveness. (Wildavsky and Caiden, 1997)

The important issues of *implementation* are related to the systems, institutions and methods aimed at answering simple and age-old questions such as: Is the money being spent efficiently? Is the money reaching those for whom it was intended?

Is the policy having the intended results? Is the policy generating unwanted and undesirable effects?

The most difficult and controversial subject addressed by the above questions – namely, whether policies have had the expected impact on society and at a reasonable cost – curiously attracts the strongest consensus.

Substantial numbers of evaluations and policy reviews are being carried out in most countries. They basically occur outside the budget cycle framework. The role of evaluative bodies, like the General Accounting Office (GAO), which report to the US Congress, even though they report neither to the center nor to the budget office, is today central in informing decision-makers about implementation. The key issue of budget office-center relations with regard to evaluations seems to be the institutions' co-responsibility for finding a proper home for this type of activity.

The subject of *efficiency in public management* – i. e. of maximizing productivity and minimizing costs in delivering existing policies – is a very political subject in which many budget offices have played a key role in the last decade, essentially as promoters of the so-called “*new public management*”, a concept incorporating business management styles and practices into the public sector. This *reform* is based on the conjunction of two elements: first, the *delegation of financial authority* to ministries – including in some cases virtually all aspects of personnel policy, flexibility as to the timing of expenditures, permission to substitute capital for labor and vice-versa; and second, the introduction in line ministries and agencies of *performance commitments and incentives*, appropriately backed up by performance measurements and sufficient power at the centre to ensure accountability and control. It should be noted however that this evolution is far from being uniform among countries. It is notable that, even though the budget office has been the forefront of “managerialism” in most places, it has succeeded in its efforts only when it obtained the full support and commitment of the policy centre. It is now accepted that any type of major initiative to modify the type of service delivery belongs on the political agenda and requires the full and joint participation of both the budget office and the center.

That the budget should further accountability and provide a key instrument of *transparency on government action* is such a staple of budget theory that it is has acquired a quasi-theological aura. Nobody is against virtue. However, the practical meaning of this principle has often remained obscure. (Lacasse, 1996)

The first question as to the meaning of this principle is: Transparent for whom? A modest operational answer is: For Members of Parliament. The case of domestic and international financial markets was evoked earlier: they can fend for themselves and/or inflict costs if they do not understand the information they are give.

The instruments used to make the budget choices and their implementation transparent differ widely from country to country. There is not any unique system likely to be applicable to all countries. They do, however, reveal the importance



of ensuring that, overall, such information does exist, whether it is produced by the budget office or by other players.

Other phenomena that used to be confined mainly to poor countries – *repetitive budgeting, remaking the budget several times a year* – have now become standard practices in relatively rich nations as well. (Wildavsky and Caiden, 1997)

A *balanced budget* as a desirable norm began to be weakened by near-universal acceptance of Keynesian economic precepts. As faith in Keynesian economics receded, the idea of the budget as a means to maintaining economic growth, stable prices and full employment also faded.<sup>13</sup> The norm of balance has eroded even further; it lacks operational guidance. (Wildavsky and Caiden, 1997)

Why did the norms erode? Answering this question is not easy. The old Politics of the Budgetary Process (Wildavsky) could focus on incremental differences because the base was largely agreed upon. When there is a disagreement about the starting point, as well as the desirable outcome of budgetary negotiation, incremental change is in trouble. Schick (1990) holds another view: prosperity declined, incrementalism has gone with it. Both budgetary norms and spending practices change together. The purpose of norms is to justify practices. The importance of budgetary norms can be seen indirectly in new practices and proposals for reform (budget resolutions, constitutional spending limits, etc.)

### **Techniques of Budgeting and Reform Attempts**

Public budgeting originated as item-budgeting or *line-item budgeting* systems in which expenditures are broken down into accounting categories, and each line of the budget represents one such accounting category or item. The line-item budget is in fact a list of resource items with an exposition of which and in what quantities these items are needed and what their money values are. When an item has been approved by the legislature, the money must be spent only for that item and not for any other purpose. The item-budgeting system may also appear in another format where all items are categorized as part of standardized expenditure items. The category and object of expenditure are the same in this case; the object indicates the category of expenditure, such as personnel, stock, equipment,

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<sup>13</sup> Although the idea of budget balance in the administrative budget has been the dominant consideration in the budgetary policy of most countries, it has gradually been realized that such a concept may be inappropriate when external shocks such as exchange rate movements or a world recession occur. Because varying levels of unemployment are a major reason why expenditures may change without comparable change in the public sector output, the concept of a full-employment budget has emerged. This type of budgeting is based on receipts and expenditures that would prevail under conditions of full employment. The approach views the actual expenditures and receipts for the coming year as of secondary importance; it assigns primary importance to the influence of the budget on the national economy. In time of recession a budget deficit may thus be presented as a necessary step toward achieving a balanced budget at full employment. Ideally, the budget should include estimates of expenditures and revenues at full employment, and also estimates of the same items at the anticipated level of employment. (These ideas have been extensively used in the United States.)



transport, printing and rent. The line-item budgeting system, therefore, has an input-oriented approach and gives little information concerning the cost or efficiency of programs provided.

According to Mikesell (1991), the line-item budgeting system has many *limitations* including the following:

- the departmental and functional basis for budget requests and appropriation;
- the short-period concept (annual basis) for costs in budget considerations without considering the long-term implications;
- the focus on departmental inputs rather than on objectives and results;
- the absence of comparison of service or project costs with service or project benefits;
- the absence of proper information for effective budget control.

Several budget reform attempts have resulted in a number of proposed new budgetary systems. Some of these systems have been tried. Some of them have survived the test, while others have not lived up to expectations. The new budgetary systems emanating from all the reform attempts and which will be explained are (i) *performance budgeting*, (ii) *multi-year program budgeting*, and (iii) *zero-base budgeting* (Gildenhuis, 1997). All these budgetary systems try to improve government performance but the ways in which they do this differ. Item budgeting concentrates on expenditure control and public accountability; performance auditing tries to improve internal administration and to keep costs for supplying public services as low as possible; program budgeting emphasizes the presentation of budget information in such a way that budgetary decision making can be rationalized, and zero-base budgeting improves administrative control as well as the flexibility of fiscal choices (Mikesell, 1991).

*Performance budgeting* had already been propagated in the beginning of the twentieth century and was also strongly recommended by the Hoover Commission of the USA in 1949. Performance budgeting strives for the most economical, efficient and effective utilization of personnel and other public resources for rendering public services.<sup>14</sup> In performance budgeting the program information is related to the cost per unit of services delivered, which is included in the budget. Presumably decision makers would then allocate new or additional funds to those agencies operating at greatest of efficiency and take funds away from those whose operations were less efficient or were decreasing the level of their efficiency.

<sup>14</sup> In the seventies, performance management has appeared in new clothes, using the characteristics of Management by Objectives. Originally, the MBO is a participative approach to the study bureaucracy which is in direct opposition to the Weberian philosophy. The system of management by objectives can be described as a process, whereby the superior and subordinate managers of an organization jointly identify its common goals, define each individuals major areas of responsibility in terms of the results expected of him/her, and use these measures as guides for operating the unit and assessing the contribution of each of its members. MBO is well suited for government because the objectives do not have to be stated in financial terms. It does have its critics however. One stream suggests that MBO is simply organizational humanism and this is not really meaningful because top management always makes the final decisions.

The three outstanding characteristics of performance budgeting can be summarized as follows:

- budget choices and budget information are structured in terms of activities rather than individual standard expenditure items;
- performance measurements are determined for each activity, the associated cost per activity unit is established, and the efficiency in the use of input resources is evaluated; and
- performance reports comparing deviation of actual cost and accomplishment from planned levels is monitored to focus the attention of accounting officers on problems which might arise so that corrective steps can be taken timeously (Mikesell, 1991).

One point of serious criticism against performance budgeting is that it concentrates mainly on the performance of government activities, irrespective of whether there is still a public demand for such activities, and not on the changing real needs of the community. Other problems with performance budgeting are:

- it is easier to measure the costs per unit of service delivered in some programs than in others.
- the equality of performance must be held constant, but we seldom measure the quality of service and program outputs over time.
- cost per unit of service delivered can vary independently of the agency's efforts, so an agency may be held responsible for outcomes over which he/she has limited control.

Multi-year program budgeting originated in the United States where it is known as *Planning-Programming Budgeting Systems (PPBS)*.<sup>15</sup> The system is compiled for the purpose of obtaining results aimed at realizing predetermined objective. According to PPBS, the objectives of government programs are to be identified, and then alternative means of achieving these objectives are to be compared according to their costs and benefits. The importance of PPBS, however, is greater from policy views since it represents the most thorough and extreme theoretical attempt to definitively reconcile budgeting and policy-making.

The main structural members of PPBS are eight terms: objectives, programs, program alternatives, outputs, progress measurements, inputs, alternative ways to do a given job, and system analyses. It is a structure whose base is accountability in the citizen market. Therefore, the objectives must be product supply and distribu-

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<sup>15</sup> PPBS was introduced into the U.S. Department of Defense in 1961 and extended to the federal budget in 1965. In practice, PPBS made little difference in federal budgeting, partly because the objectives of governmental programs were difficult to specify and partly because comprehensive evaluation took too long. PPBS were abandoned in 1971 and since then it has been implemented only by some states and local governments in the USA. Comparable schemes in Western Europe, such as the method called "rationalization of budgetary choice" introduced into France in the late 1960s and the so-called Program Analysis and Review in Great Britain in the 1970s, were likewise unsuccessful.

tion. Accordingly, programs are conceived and executed as production/distribution entities. Consequently, program alternatives are different production/distribution entities that might offer better benefit-cost ratios than existing ones. End products become the only items construed as outputs. Progress is viewed and measured in terms of output/distribution timing and effectiveness. Hence, the inputs are “whatever resources it takes to get the production/distribution job done.” As a result, alternative input-mixes become important comparison bases within any given program. Finally, systems analysis contributes diagnosis and appraisal to the whole.

Multi-year program budgets also have other characteristics (Gildenhuis, 1997):

- The lifetimes of programs often extend beyond the budget period.
- Steps in the preparation of program budgets force departments to use cost-effective analysis as well as cost-benefit analysis techniques.

According to Mikesell (1991) program budgets create important complications for large organizations such as government. Without a simple system of horizontal co-ordination which is easily understood and delivers quick results, PPBS provides data that cannot be used by budget decision makers, with the results that choices are still made in the original fashion of the traditional item budgetary system. This obstacle is the main reason for the failure of multi-year program budgeting.

Other difficulties are:

- Since a number of activities contribute to the accomplishment of a single policy objective, making a rational program classification is almost impossible.
- Cost-effectiveness analyses as well as cost-benefit analyses may frequently not be as important for public decision making as is generally accepted, and there is also no acceptable scientific method by which the overheads of a government can be allocated to its various policy objectives.
- It is possible that multi-year program budgeting will have very little effect on the decisions of political representatives in regard to politically sensitive issues.

*Zero-base budgeting* is also originated in the US. ZBB emphasizes the ranking of programs in priority order and the allocation of funds on this basis. It derives its name from the fact that conceptually managers are required to justify every dollar requested from zero up. The implications are that if they cannot, their programs will be reduced or eliminated. It is based on making a choice among several packages. These packages indicate the amount of increment for a budget based on the previous year’s budget. It takes into account a description of the actions intended to be performed, achievement from the actions, alternatives for accomplishing the same objectives, and calculations of a benefit-cost ratio. The decision packages are ranked from most to least attractive at the same time a decision is being made concerning the level of total expenditure for the year.

According to Phyr (1973) ZBB requires each government institution:

- to review systematically all activities and programs, existing as well as new;

- to review activities and programs on the basis of performance, results and costs;
- to give preference to policy making over and above decision making on budget figures, and
- to enhance and support scientific analysis in the budgetary process.

Zero-based budgeting can be viewed as both as a “bottom-up” and a “top-down” approach, because it allows lower-level managers to participate in the ranking process but saves final decisions for politicians and senior managers. In comparison with PPBS, which is a macro-economic instrument for centralized decision making on policy matters and for the allocation of resources to different policy objective, ZBB is a micro-economic instrument.<sup>16</sup>

One important aspect of zero-base budgeting that facilities holding the line on spending is that the revenue constraint can be set first and the level of expenditure cut to fit it. This help treasurers and other guardians of the public purse to withstand the onslaught of spenders. One flaw of zero-base budgeting is the effect of annual review to determine whether some programs will continue to exist has on the morale of employees. Presumably, large organizational units could be eliminated with great loss of jobs on the occasion of these reviews.

Other examples of reform attempts that can be considered as subsystems of the three main systems described, the Balanced Based Budget (BBB) system and the Policy and Expenditure Management System (PEMS) are being introduced in the US.

In Canada, the Balanced Based Budget (BBB) was created to neutralize some of the legislative hegemony over the budget. The budget reform was meant to achieve two goals: provide strategic control, and in so doing, consolidate the government’s management control over the executive branch. The BBB system introduced resource limitations as a first step. After the early projections were reviewed, the governor allocated expected state general fund revenues among agencies in order to create a budget-base that is the centerpiece for all ensuing budget construction. Each agency was directed to prepare a budget in which total general fund outlays exactly equaled the assigned base level. Therefore, the summation of all planned agency outlays exactly equaled expected revenues and the base was a balanced

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<sup>16</sup> Two terms may also be associated with ZBB:

*Cutback budgeting* is the term applied to efforts to reduce spending below the level that would ensue if current policies were continued. It seeks to harmonize macro and micro decisions by implementing constructive fiscal objectives through cutbacks in specific programs. In cutback budgeting, macro and micro decisions are linked by baselines which measure the gap between the trend in revenues and expenditures and the government’s fiscal target (Schick, 1988)

*Decremental budgeting* deals with budget reductions which are at the margins – a little less rather than a little more. It concentrates on discretionary spending where the cuts are easiest to secure and do not entail changes in law. It provides increases below the inflation rate and searches for opportunities to contract programs.

budget. To retain the characteristics of balance, recommendations for expenditures in any agency in excess of the allocated base amount, had to be offset by a corresponding reduction elsewhere in the budget. The government's base allocations applied at the agency level and not at the program level. Agency managers were left free to propose a distribution of the base amount across programs within their jurisdiction. Issue papers prepared by agencies were submitted to the government with questions the agencies believed should be considered when dividing expected revenues among agencies. BBB encouraged "cost control," program level responsibility for "priority setting," and an "early spot" of problems. Most of all, BBB stilled the agencies' claims to a common "fair share" of additional budget authority each year, instead pushing large new-money budget increments toward single objectives that the government's strategy favored. In the American experience, this exercise was at the state-level and the governor of a state would be the synonym of "government".

The Policy and Expenditure Management System (PEMS) is designed to integrate expenditure considerations and policy decisions. In Canada, PEMS was designed to stimulate reallocation by crediting each envelope's policy reserves with savings due to program changes. These savings could be applied to policy initiatives within the same envelope. However, this incentive was diminished somewhat by giving the savings to the policy envelope – which typically consists of a number of government ministries – not to the ministry from which the funds were taken. PEMS combines the centralization of decisions on spending totals within the Cabinet and the decentralization of expenditure management responsibilities to spending ministries. PEMS rules authorize departments to finance relatively minor policy changes from the approved levels, subject to overall guidelines developed by the Treasury Board to ensure that the changes are consistent with the department's mandate and government-wide controls in the use of public funds.

Performance budgeting, multi-year program budgeting and zero-base budgeting are all attempts to rationalize budget decision making and to eliminate the disadvantages of the traditional item-budgetary system. The reasons why budget reform efforts have failed are not clear.<sup>17</sup> All three systems originated from the private sector where they were applied with success. Political expedience and in-

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<sup>17</sup> “. . . budget reforms, although widely experimented with throughout different OECD-countries, show a relatively short life cycle. Some of the reforms succeeded each other so quickly (for instance PPB, MBO and ZBB in the USA) that they rather suggest the repetitive creation of a series of new symbols, ceremonies & rituals, put in place to sustain the same image, the creation of a new images of the public sector. . . A possible explanation might be that the application of the new budget formats and procedures redistributed information, thus creating new information asymmetries, and disturbed existing balances of power. Hence stakeholders might have been forced to early abandon the reform and replace it by a new one, or new stakeholders might have been able to impose their 'definitions of meaningful budgeting', thus triggering a reform as well. If a theory could be developed which confirms, or corrects, these assertions with regard to budget reforms, then we might be able to explain why budgeting, and other fields of public management, are subject to continuous changes.” (Van Reeth, *Search for a Meaningful Budgeting*, 1996, p. 23.)

consistency, however, make the application of budget reforms very difficult for the public sector (Gildenhuys, 1997).

### **Budgeting in Central and Eastern Europe during the Transition**

Budget reform has been one of the most difficult challenges for the nations of Central and Eastern Europe (CEE) since the dramatic political changes which took place in 1989. They have had to adapt radical new budget policies while reinventing budgetary institutions to facilitate both economic restructuring and democratization.

To modernize the budget system in transition countries, it is important to understand the legacy of the command societies from which they originated. In command societies, the chief functions of the government were to organize *overall planning* and production of goods and services. In many of these countries, the most important document in terms of the creation of incomes and welfare was “the plan”. Although there were many functions to be carried out by means of state budget resources that derived directly from this plan, the role of the budget was less important than that in market economies.

The *organizational structure* supporting the planning and budgeting activities in most command societies was a typically hierarchical structure, where all formal information traveled vertically. The role of the ministry of finance in the former command societies was chiefly to provide a source of finance both for physical production and social transfer flows, for which directions and volumes were decided elsewhere in a planning center. The budget process was basically a negotiated procedure, in which the underlying “directive power” of the monopoly party determined the outcome of the negotiations at all levels. Transition countries recognize the importance of effectively managing government expenditure and are undertaking many important reforms in this area. Nevertheless, they are still burdened, to an extent that varies from country to country, by their inheritance from the previous regimes. (Allen-Tommasi, 2001)

Budgeting is one of the most critical, integrative processes in governing. This may be even truer in the case of the nations of the former Eastern bloc in the rapid transition towards representative democracy and market capitalism. Martinez-Vazquez and Boex (2000) distinguish *three stages* of budgeting and fiscal management reforms in these countries. During the first period, most transitional economies saw some important economic reforms but a lack of budgeting and fiscal management reforms. In the second period, a set of fiscal reforms were put in place in response to a macroeconomic crises. This was generally of an emergency nature and failed to establish a sound framework for fiscal discipline and efficient expenditure policies. As a result, renewed fiscal crisis spurred more structural fiscal reform efforts during the third, ongoing period of transition.

Budget reforms have partly been influenced by theoretical considerations. As we seen earlier in this chapter, much of the research and scholarly literature on budgeting emanates from the United States, where in the 1960s “incremental-

ism” became the dominant theory of budgeting. By the late 1970s and 1980s, incrementalism was seriously challenged by a theory based on the differentiation between microbudgeting and macrobudgeting. Given the magnitude of the changes in Hungary and other CEE nations since 1989, budgeting there is anything but incremental. The microbudgeting – macrobudgeting dichotomy is particularly useful for explaining budgeting in CEE nations. The economic transition has led to an even greater emphasis on macrobudgeting and external constraints than in other nations. (LeLoup et al. 1998)

Caiden and Wildavsky (1974), and Wildavsky (1986) have suggested some hypotheses about budgeting in poor countries which are adaptable in part to the situation in CEE, too. Their work pointed to the relationships between wealth and predictability, between uncertainty and repetitive budgeting, and suggested the potential importance of political culture in comparing budget processes. The hypotheses have been confirmed (LeLoup et al. 1998). First, the rapid transition from command to market economy in itself has reduced predictability in budgeting and short-term reductions in wealth have tended to increase uncertainty. Second, as uncertainty increased, repetitive budgeting – the need to frequently readdress and revise taxing and spending decisions – has also increased. Third, a political culture cultivated both among the mass public and elites under communism with centralized resource allocation, artificially low prices, and few taxes on individuals, made it more difficult to adapt new budgeting processes and policies, particularly in the short run.

Both *budgetary and political institutions* should be important in explaining budget outcomes. Outdated budgetary institutions that have not adapted quickly enough, that are fragmented and lack accountability and control mechanisms, and do not provide accurate and definitive budgetary information can serve to obstruct efforts to implement major budgetary changes.

In many transition countries, the tendency to impose decisions from the top, without adequate consultation and co-ordination, still creates inefficiencies in policy development and implementation. The distribution of budgetary responsibilities between the ministry of finance and line ministries is often not clearly defined. The *key institution* of the budgeting process is the ministry of finance. All core functions are concentrated here. It is responsible for creating the budget proposal, for controlling the execution process, etc. The most frequently debated point in the system is macroeconomic planning. Governments tried to shift this function away from the ministry of finance in order to create a centre for macroeconomic planning and to ‘terminate the bias toward short term, fiscal issues’. But the experiments failed. While the economic ministry also plays great role in this field, the ministry of finance has kept its central position.

Recently some broad *reform objectives* have been pursued in CEE countries. Achieving budget comprehensiveness and unity is one of them, including (i) adoption of a standard fiscal classification and reporting system within all budget organizations, (ii) incorporation of extra-budgetary funds into the budget, (iii)



integration of capital budgets or public investment programs into the budget process, and (iv) integrating other off-budget phenomena into the budget. Efforts are also being made in fields of resolution of the issue of budget arrears, building capacity and institutional strengthening in budget formulation and execution, and establishment of sound intergovernmental budgetary relations. (Martinez-Vazquez and Boex, 2000)

The *political transformation* from a one-party system to a multi-party democracy often failed to include mechanisms in the legislative process to promote reaching consensus, achieving the compromises needed for decision-making. The inability of legislatures in many transitional countries to pass the annual budget before the beginning of the budget year is evidence of this problem. (Martinez-Vazquez and Boex, 2000) Besides some hot political issues, the most intensive political debate occurs about the budget. The vote for or against the budget proposal of the government is the main indicator of the stability of the government; the incumbent and opposite parties could be defined according to the vote over the budget. Many countries also suffered from lack of experience with parliamentary institutions, and from lack of fiscal analysis capabilities within the legislative branch. Parliaments are inexperienced and are generally unable to perform their control tasks effectively.

As far as *budgeting techniques* are concerned, none of the transitional economies has fully adopted modern budgeting techniques similar to those in western countries. It is acknowledged that significant developments have occurred in management control practices and procedures have been introduced in businesses worldwide in the recent past. Despite the differences in objectives between government and business, it is worth evaluating the extent to which current business practices have affected government budgeting practices in transition countries. With this in mind, one should respond to the following three issues: to what extent is performance budgeting (as opposed to line-item budgeting) used in practice, to what extent is accrual accounting used in addition to the mandatory cash-based accounting, to what extent is a multi-year time horizon used in the budgeting process?

In general, all the transition countries employ *line-item budgeting techniques*, which take into account only the previous year's cost of services or the costs related to operating the necessary institutions. However, there is a budding realization that the input (cost) is less significant than the output (performance). Thus, although not widespread, examples can be found of the use of different types of *performance budgeting* systems. The use of accrual accounting in addition to the mandatory cash-basis accounting is being discussed seriously in most countries, but there are no examples of actual implementation. Similarly, the use of a multi-year time horizon in the budgeting process is agreed to be a good idea, but difficult to put into practice. Even in those countries where there is a legal requirement to use a multiyear time horizon, for example Hungary, policy makers give very little credence to the data in the budget document extending beyond one year. The most commonly cited obstacle to extending the budgeting time horizon is accurate forecasting of the future actions of the central government. (Hogye, 2002)



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# Chapter 11



# Social Policy in Central and Eastern Europe After the Transition

*János Hoós*

## Introduction and Overview

One of the major accomplishments of the socialist systems of Central and Eastern Europe (CEE) was the relatively equal distribution of income they attained. (See Table 1) Low income inequality stemmed primarily from guaranteed employment and low wage differentiation in the state sector, as economic and social goals were often combined in socialist firms. The social policy was characterized by “cradle-to-grave” state paternalism. Government’s social protection role consisted primarily of administering state-run pension systems, and generous programs of sick and maternity pay, and providing welfare benefits to marginal social groups, such as single mothers, the handicapped, and the chronically ill (including alcoholics and drug addicts). Such benefits were often provided in kind (such as hot meals, home nursing care, or cloths), as frequently happens with charities in market economies. Cash-based welfare systems were not well developed. Firms took an active role in providing social services to employees, they had a social role, a “duty” to provide employment to alleviate social problems in their respective regions.

The transition to a market economy was virtually certain to lead to higher unemployment and somewhat greater income inequality. This required a redefinition of the social safety net, in essence an “unbundling” of the economic and social roles previously assigned to enterprises. The main objective of the enterprises should be efficient production, which not only generates economic growth but also protects existing jobs and creates new ones. Governments should be responsible for protecting vulnerable groups – whether the unemployed, the elderly, disabled, or others let out of the productive economy – and providing (directly or indirectly) basic social services such as health, housing and education. Individuals should in turn be responsible for finding jobs (with some assistance from the state) and keeping them through satisfactory performance. (A. H. Gelb and C. W. Gray 1991)

In the first stage of the transformation of the economies of CEE there was a deep economic crisis, creating huge budget deficits and high unemployment (J. Campell 1992). The economic crisis and budget deficits of the governments meant that they no longer could maintain, finance and provide basic proper social services. Neither were local governments prepared to assume these functions, nor were there any independent social organizations that could substitute for the public provision of basic social services to a significant extent. (C. Offe. 1992.)

There were four interrelated social policy problems during the transformation: (a) the problem for citizens to find secure and durable employment and income; (b) the business problem, in which firms could no longer rely on soft budget constraints and thus had to abandon their direct social welfare functions; (c) the budget

problem of unburdening the state from price subsidies, which resulted in rising consumer prices and declining real incomes and; (d) the labor market problem resulting from privatization and the need to develop new and specialized social policy institutions.

Table 11-1

Country or region	Gini coefficient
<b>Hungary</b>	<b>24,4</b>
<b>Poland</b>	<b>24,3</b>
<b>USSR</b>	<b>25,6</b>
<b>China (urban)</b>	<b>23,9</b>
<b>(rural)</b>	<b>23,1</b>
<b>Czechoslovakia</b>	<b>20,7</b>
<b>Yugoslavia</b>	<b>32,1</b>
<b>Eastern Europe</b>	<b>25,4</b>
<b>Latin America</b>	<b>49,5</b>
<b>South Asia</b>	<b>42,8</b>
<b>Asian NICs and Japan</b>	<b>38,3</b>
<b>Western Europe</b>	<b>31,4</b>
<b>United States</b>	<b>32,6</b>
<b>Sweden</b>	<b>20,5</b>
<b>Norway</b>	<b>24,3</b>

*Source :Milanovic (1990)*

*Source: (A. H. Gelb and C. W. Gray 1991)*

*(The Gini coefficient is a measure of inequality that can be derived from the cumulative distribution of income across the population, ranked by their income level – the so-called Lorenz curve. A larger Gini coefficient implies greater inequality. It is defined as half the mean difference between any two observations divided by the mean.)*

These four interrelated social policy problems, necessitated three consecutive steps in social policy-making be taken in the post-socialist countries of CEE Europe. However, the urgency and sequences of them often resulted in their taking place simultaneously in these countries: (a) emergency measures; (b) institutional building and reforms; and (c) adjustments within established institutions. (V. Pestoff. 1995)

The social policy system needs to meet four basic requirements: (a) strengthening its role as a defense against poverty, (b) rising the quality and equity of social programs, (c) ensuring the financial sustainability of the system (d) restoring incentives. Social policy includes: (1) social income in cash (old age, survivors and disability pensions, sick pay, family allowance, maternity and child care allowances, student scholarships, social assistance, and unemployment compensation), (2) social income in kind (health service and pharmaceutical subsidies, social services, edu-

cation and training, other subsidies such as culture and sports, and labor market services), and (3) housing and other consumer subsidies.

Reforms had to extend to comprehensive transformation of the large distribution systems (pension, health, education, housing, social benefits), reduction of social benefits according to the need and partially providing services in the market economy. There was consensus in CEE that due to their inner shortcomings and to the condition of their economy reform is unavoidable and indispensable. But the success of the reform depended on sustainable economic growth of their economy. This growth could provide resources that could stop the deterioration of the welfare system. Without sustainable economic growth, CEE countries were not able to reform their welfare system and unable to match Western European standards and for lack of this growth they can slip back into the condition of under developed countries, postponing reform.

The key issues for the design of social policy reform were:

- how to improve the efficiency of existing social programs so that a higher level of welfare is gained from a given level of expenditures, and
- how to target reduced expenditures to ensure that while some individuals experience lower transfers no one put at risk of poverty or undue hardship.

The policy priorities that were established were:

- the growth of total pension outlays to be curtailed through tightened eligibility;
- structural reform of sick pay, family allowances and maternity child benefits and housing subsidies to reduce expenditures and to improve targeting;
- an increase in the level of social expenditures devoted to unemployment support and social assistance;
- a marginal increase in the share of GDP allocated to health and an expansion of enrollments in secondary and higher education; it is low by international standards and it is a good investment in human capital, resources.

The requirements and goals listed above have been partially met and achieved. The results vary by country by country depending on their development levels and economic growth. *The concept of reforms is rather well developed and commonly accepted in countries of CEE, but the implementation of it is in very different stages.* Therefore, we first outline the *concept of the reforms* and after that we describe *what social policy reform has achieved.* We start with the pension system.

### **Reform of the pension system.**

The pension system is one of the basic elements of the social policy. The state has to deal with this question because:

- those who have income, but do not save for old age, create an imperfect market due to the risk which forces market-oriented insurance companies to charge

high fees that, many people cannot afford; also, a hyper inflation can wipe out the value of savings,

- many people do not have sufficient income to save for old age;

In many these cases all the people become a burden to society.

Therefore a proper system has to be developed in order to minimize this burden. That is the basic function of the pension system.

The state sponsored pension system started to develop during the 19th century in Germany as a major part of social protection system initiated by Bismark. Since that time a very elaborate and complex pension system has been created, especially in the developed industrialized countries. But all the countries of EEC have pension system problems that have to be dealt with. The main issue is how much role the state and the individual should play. But there is a consensus that a more transparent combination of three distinctive pillars are needed for old age security to meet *two basic objectives; the saving insurance objective and the redistribution objective. One pillar cannot fulfill both requirements.*

The reason is that the design of every pension system, consisting of both public and privately provided management activities, has a built in conflict of interest:

- to save money for retirement and
- to provide a minimums living standards in retirement regardless of what was actually earned and contributed.

One form of this arrangement could be:

- a citizen' s pension providing more or less flat benefit to those who reach old age, a minimum pension for servicing,
- an earnings-related mandatory retirement saving plan,
- a voluntary pension plan.

How can the existing mandatory pension scheme be reform? The main policy effort should be directed at enabling the existing pay-as- you- go (PAYG) scheme to survive well into the 21<sup>st</sup> century without becoming an intolerable burden on public finance.

There are three actions that can be taken:

- increasing the effective retirement age
- broadening the tax base by taxing the pension itself
- changing the indexation a way that creates saving in the pension expenditures.

In addition to this, there is a need to create a new system:

- a flat citizen pension for example, universal benefit provided past age 65,
- a new second pillar that will be still mandatory, but offer a clearer link between one's own contribution and the return one receives. It can be less generous than the system that now exists. It can be arranged on basis of PSYG, where the annual contributions are equivalent to the annual pension spending. Such



a fully funded pension schema would accumulate assets which are equivalent in value to all outstanding pension liabilities. Accomplishing this, however, requires development of capital market and effective regulation.

The design and implementation of a well articulated transition from a public PAYG system to a new system lie at the core of successful pension reform. The new system should be able to generate some efficiency gains, even in the transitional period and, at the same time, prove acceptable from a fiscal point of view.

The speed of the reform also has to be taken into consideration. There can be two main strategies, a gradualist one and an accelerated variant. Both have advantages and disadvantages that have to be examined before decisions are made regarding which is going to be chosen.

One of the most urgent social issues in CEE is the reform of social protection against the risks of old age and disability. In CEE until 1990 only the single pillar, pay as you go (PAYG) option existed. All governments of the countries have declared their readiness to transform the existing single pillar systems into three pillar systems as recommended by the World Bank, IMF, EU Commission. However, the experience of more than ten years of reforms shows how difficult it is to implement this. As observed in most of the CEE countries, old age pensioners and invalids constitute a significant electoral group with an easily identifiable aim. This makes the issues of pension reform, – indeed, the whole social policy reform – too highly political and dependent on electoral cycles. Furthermore, system reform requires at least one generation before achieving its full effects.

The first concrete step towards a three pillar scheme was taken in Hungary in November 1993 with passage of the Act on the Voluntary Mutual Benefit Funds. It regulated the optional retirement savings addition to the mandatory national PAYG scheme. People, especially high earning whitecollar mainly middle-age people, are using this scheme. It is not mandatory, but voluntary. It is saving oriented and using the resources efficiently. The state supports it by preferential tax treatment, but it has to be regulated in order to be safe. However, this system is yet not well developed.

The real challenge in modernizing the Hungarian pension system lies with the choice of the second pillar, which has to solve the present crisis in the Hungarian PAYG scheme that results from:

- unemployment
- tax evasion and
- early retirement.

One of the special problems in the Hungarian system is the high dependency ratio. (That is, the number of pensioners, including under retirement age disability pensioner, divided by number of contributors to the pension funds.) It was 0,66 in 1993, one of the highest in the world. In 1990 it was 0,50.

It rises when:

- formal sector jobs are lost, because activity ceases or it goes underground and evasion occurs,
- pensions are awarded to those under 60 for men and 55 for women,
- explosive growth of new disability pensions takes place (for example, in 1993 27% of all pensioners received benefits originally awarded on disability grounds), which sometimes results from attempts to escape from unemployment.

The high dependency ratio could have led to unsustainable expenditures. To avoid this, Hungary introduced the three pillar system (in 1996), increased the retiring age (in 1996), and introduced the funded pension component (in 1997). Although the reform is not yet complete, new pension laws have been put in place.

The Czech Republic and Latvia have followed the Hungarian approach. In other CEE countries, there has been much debate but little change in policy so far. This lack of action may be dangerous because many medium-term projections show that the present arrangements are not sustainable.

### **Reform of the Health System.**

CEE has an unfavorable health status. (For example a Hungarian man aged 45 can expect to live nearly six years less than his Austrian counterpart. Life expectancy at birth in Hungary 1991 was 65.1 (not significantly better than in the late 1920s), and the same figure was 72.6 in Austria. In the early 1960s was around 67 in both countries. In Russia, male life expectancy declined by six years between 1989 and 1994). That scandalous statistic suggests avoidable human tragedy on a massive scale, and huge economic costs through foregone output and intensified catastrophic health care needs. It can be attributed to:

- unhealthy lifestyles, overwork and related stress and occupational and environment hazards,
- the failure of CEE's health system to evolve until recently in response to these needs, building perhaps on the false assumption that medical care alone, without corresponding changes in individual behavior, would solve all of the problems of deteriorating status,
- poor quality of health care.

CEE's health system faces three major challenges today

- to reverse the declining trend in life expectancy
- to improve the standards of services offered to the public and
- to maintain the almost universal access to service.

These objectives must be attained in an environment of greatly restrained financial resources. Therefore, the key focus of health reform must be on reallocation within, improved outcomes and a better distribution of health care by focusing on:

- putting the financial reform back on track
- better combining inpatient and outpatient services,

- restructuring pharmaceutical expenditure by limiting full coverage to a core package of essential drugs and basing the level of subsidy on the price of the lowest cost equivalent drug,
- regional allocation of budget resources on a capitation basis in order to force a more equitable distribution of care and reduce inefficiency,
- clearly defining the limit of the public funded Health Insurance Package.
- enhancing the autonomy of managers of health facilities (Managers of the health facilities need to be granted greater autonomy to run health institutions as independent economic units, responding to the signals offered under the new financing systems. This includes the freedom to hire and fire staff and set salary levels on the basis of performance. To reach this end, the current laws that cover health workers under public service employment laws would need to be revised),
- restructuring the hospital system to reduce the persistence of excess capacity in the health service system, and particularly in acute hospital care, which continues to be a major cause of inefficiency, of financial shortages, and ultimately of poor quality services. (For example, in Hungary in 1993, there were 33 physicians and 101 hospital beds per 10,000 population; the average for EU countries, where per capita budgets for health are significantly higher than in Hungary, were 25 physicians and 90 beds per 10,000 in the same year. Reducing excess capacity is a sine qua non for successful health reform).

Countries of CEE need to come to terms with the fact that the full range of medical technology known today cannot be provided in all cases of need with per capita public budgets at around 250 – 700 dollar per year. This would require extensive analyses of:

- the relative cost effectiveness of alternative interventions for specific diseases and
- the extent to which the system can afford to pay for various alternatives.

In Hungary, the reforms began in late 1980s:

- changes in the financial system were introduced – financing of health expenditures was shifted from state budget to a compulsory health insurance system by creating a Health Insurance Fund (HIF),
- subsidies on pharmaceutical retail sales were also transferred to HIF,
- family physician services and free choice of family physician were introduced
- changes in ownership arrangement to place, with ownership of public health facilities transferred from central to local governments and autonomous private practices, including private health service enterprises, legalized,
- a National Health Promotion Program was begun (This program was initiated to increase awareness on the importance of health-promoting behavior and to develop programs to help individuals make these changes, and to train health professionals to offer such help).

The Czech Republic and Estonia have achieved similar results in health reform to Hungary. However, even these countries are far from completing the reform. In

the other countries of CEE, reform is mostly in only a conceptual phase, which involves adopting new legislation and establishing a legal framework (Health Insurance Law) for reform. Most of the constitutions of CEE countries guarantee medical services to their citizens. Medical insurance systems are being developed, subsidies on pharmaceutical are being reduced, and eligibility for sickness benefits that were liberally granted in the past, are being tightened. The development of private alternatives in services delivery for health have been encouraged, but the speed of reform differs from country to country. The implementation of this reform is slow and there are serious financial problems as well. For example, total state expenditure in the field of public health in 1995 was equal to 2% of GDP of Russia. As a result of the increasing financial problems facing public health in Russia, it is difficult to meet the constitutional guarantee to the population in the field of health protection and medical services.

### **Family Assistance Allowances**

In CEE there are many benefits available to families. The main programs are the following: maternity leave, birth pay, allowances for child-care, family allowances support to the mothers of many children, assistance programs for the wives of military recruits.

The most important of these benefits in financial term is the family allowance. The objective of this benefit is to support the well being of mothers and children, ease the employment/child care problem for mothers, and boost fertility. In the countries of EU there is a relatively high public spending on family benefits. For example, in Hungary in 1993, the family allowance was paid to the parent of 2.28 million children and totaled 3.0% of GDP. This level of expenditure places Hungary on a par with the most pro family countries in Europe, for example France (2.7% of GDP) and the Netherlands (2.1% of GDP). The fact that that high public spending on family benefits is coexisting with increasing poverty among children clearly points to the need for a fundamental overhaul of the system. However important the objectives of encouraging fertility, supporting all parents during the years of early childhood, and assisting all families to help meet the costs of child raising, no country in the world can afford to stand back and watch increasing number its young citizens fall into poverty when it can prevent it. Poverty prevention and poverty alleviation therefore must be considered the overriding public policy objective for family allowances. In most of the CEE countries the situation is similar to the Hungarian one.

The approach has to be one of greater selectivity and targeting. Targeting can be achieved through:

- means-testing,
- bringing the transfer within the framework of income taxation,
- providing payments to families exhibiting certain characteristics that are known to be closely correlated with poverty heterogenic approach.

The majority of countries of CEE apply several of these approaches. Hungary, for example, uses both the means testing and poverty related approaches. In most countries, however, reform of the family assistance programs has not yet begun. Governments approach these issue incrementally. Their main concern appears to be improving existing programs. Hence, they introduced new programs only when needed. (Violet Roxin – János Hoós. 1995.)

### **Reform of Housing Policy**

Housing reforms encompass many issues in addition to rent and subsidy reform and the accompanying wage adjustments. Establishing a market for housing requires, for example, an overhaul of the system of housing finance, with major implication for the financial system in general. It is also requires privatization of a substantial portion of the public housing stock, with relations to broader privatization and macroeconomic policies. Improving the functioning of housing markets requires extensive legal and institutional reforms to enact and enforce zoning and building codes. Finally, extensive reform and restructuring are needed in the construction industry to reorient incentives and improve productivity.

In CEE, coping with the housing problem was traditionally regarded as one of the most important social functions of the state. Thus, it was responsible for the bulk of housing construction. Between 1945 and 1990, a significant and growing number of flats were constructed. The state provided preferential credit, exercised control over the distribution of flats, and kept rent low by giving subsidies (12 – 13% of the state budget). Powerful state intervention and regulation were characteristic. The state nationalized most of the privately owned apartment houses in the towns and practiced rent control and price control of the materials used for house building. The state has not only built a relatively large number of apartment houses, but rented them at a low (substantially below the social cost) rent. The mechanism of allocation of state-owned flats was characterized by administrative rationing according to income, size of families (number of children) and “importance of work” done by applicants (position in the management hierarchy, economic importance of the factory demanding an additional or a new work force), rather than by using market means, such as market prices and interest rates. The market has developed in the private sector, especially in “the gray and black economy”.

What were the consequences of these characteristics of the old housing policy? In CEE the states built a great number of flats. For example, in Hungary from 1960 to 1980 about 3 million new flats were built – 1 million by the state and 2 million by private persons. In that sense, housing conditions have improved in Hungary. (One out of three families has moved into new and more comfortable housing or flats. In Hungary there are now 3.8 million flats, the population is 10 million and the number of families is 3.8 million). About 2 million so-called “weekend houses” have also been built. Most of the houses built by private families are larger than the real need and house building was used as a favorable capital accumulation method because of the heavily subsidized price of building materials and the

low subsidized interest rate. (The average subsidy rate was about 100% and the mortgage rate was 0 – 3%. These credits were given for 25 – 30 years. The market interest rate was 10 – 30%).

There was an unrealistically high demand for flats, building materials, and credit. A huge “shortage” developed in these fields. (In Hungary for example, the shortage in terms of quality and quantity was 40% of the total number of flats in 1960. The shortage, however, disappeared in 1994 due to the introduction of a market price and interest rates). Because of these “shortages” a special market developed to get the right to rent state owned flats, building materials and preferential credit. “Re-renting” became widespread, which in fact created a real market rent. “Personal connections” and bribery became an important means of allocation.

This created an unjust income distribution. In Hungary, those who have the right to rent a state-owned flat pay 10 – 20 US\$ rent per month, while the market rent 300 – 500 US\$, and because they did not have to build a privately owned house, which costs 20000 – 30000 US\$ they have, in fact, received such an amount as a “social gift”. There was no necessary restoration of the state-owned apartment houses, and due to this, the condition of houses has deteriorated, causing a huge loss of national wealth.

An irrationally high proportion of ration income has been spent on weekend houses. These resources could have been used more efficiently for productive purposes for example, for keeping state-owned house in good shape or building new flats. One of the reasons for this overspending was the heavy direct and indirect housing subsidies. Through this, stated housing policy has contributed a great deal to the well known adverse affects of budget problems on the economy.

Housing policy, because of its rigidity, has hampered the mobility of the labor force as well. The deteriorating budget situation automatically resulted first in an arrest of growth and later on in a slow-down in housing construction in CEE countries. The decline in housing construction was dramatic in Hungary, Latvia, Lithuania and Russia, where it was only one-tenth in 1990/91 of what it had been in the second half of the 1970s. (Violet Roxin – János Hoós 1995.) Due to the budget problem, the state “retired” from the subsidization of housing, leaving households to face the growing costs alone.

What are the requirements for reform? There are two main reasons for change: to improve the efficiency of the housing policy; to decrease the burden on the budget affected by the housing policy. These reasons are very highly interrelated. The long-term objective is the establishment of a market-oriented housing system. Nevertheless, it will fulfill this objective only gradually.

What steps should be taken or might be taken?

1. *Privatization.*
2. *Creating a market price for rent and credits.* Subsidies should be targeted to those groups in the population who without these cannot solve their housing

problems, that is, to low income families in special circumstances (for example, families with a low income who have many children). The requirements of subsidies are :

- the flat owner has to get the market rate, the tenant should get the subsidy (for example, income subsidy for the family),
  - the lending bank should charge the market interest rate and the government should subsidize those who get the rent (for example, a young couple who just started a family).
3. *Creating a better legal environment*, to facilitate market transactions and to decrease transaction cost.
  4. *Creating special social welfare policy by*, for example, dealing with the problems of homeless people.
  5. *Creating a special policy for coordinating the interest of the different pressure groups*, interest groups, lobbies. These groups include, for example, workers who live in large industrial towns and persons who have preferential credit with low interest rate. The state should handle the social tensions caused by the reform,
  6. *Careful timing and sequencing of each of the steps*. This is very important. For example, the first step should be privatization. Some measures should be announced beforehand to give options to citizens affected by the reform steps, for example to allow them to choose between moving into a lower rent house or paying the higher rent.

Successful reform of housing policy can alleviate housing shortage and improve the average quality of apartments. It has to be underlined, nevertheless, that government control may be necessary even after a successful restructuring. Even in advanced market economies, the housing sector does not rely exclusively on market principles. The reason for this is the structure of the housing market and the danger of misusing monopolistic situations on the one hand, and the indispensability of social supports in housing policy on the other hand.

According in rent reform, rents are to be increased gradually above the rate of inflation, taking into consideration the quality of apartments and considering the income of families. As rents go up, it will be necessary to create at the same time a protection system for the poorest groups in society, by partly covering their rent with welfare funds. Similarly, a progressive approach is required in connection with the interest rate on housing credits. Here, the increase in the value of apartments is to be taken into consideration as well. Social subsidies should be changed gradually to complement income, and not to decrease rent exclusively. Also, local governments should accept common general rules concerning the sale and the maintenance of apartments. Subsidies on a non-social basis should be eliminated gradually, and the subsidization of the strata of the population which are most in need should be based on their actual incomes.

The building and maintenance of the housing stock is not the responsibility of the state, but of market participants (entrepreneurs and private contractors and the inhabitants). In housing management, the task of the state is to establish the framework within which families can have their housing requirement met in proportion to their financial position and to provide assistance to those who, because of their social position are unable to afford and maintain housing at even the socially accepted minimum level.

There is no reason to handle housing management separately from the economy as a whole and employ different regulations from those applied to other economic sectors. However, housing constructions and refurbishing can act as a vehicle for invigorating the economy. Because of its relatively low import content, such activities do not significantly increase the balance of payments deficit. If adequate benefits are made available, growing numbers of homes can be built by entrepreneurs on a profitable basis, which can also be supported by banks (with personal income tax benefits), thereby increasing the abilities of families with different financial conditions to obtain homes.

Hungary is well advanced along the reform road in this area. It now absorbs less than 1% of GDP in this form of state housing assistance. 80% of housing stock is in private ownership. There is a rather well developed housing market in Hungary. The majority of CEE countries, however, are in the early stage of reform. The privatization and the liberalization of the rent of houses has been taking place in every country, but number of houses built – so called “social housing” – by the state for social purposes is still very small, and the number of the homeless people is still high.

### **Reform of the Education System.**

The one reason that justifies government support for education is that there are important externalities associated with having an educated citizenry. A society in which everyone can read can function far more smoothly than a society in which few can read. The justification for public support of education also arises from concern about the distribution implications of the private financing of education. Richer individuals will want to spend more on the education of their young, just as they spend more on cars, homes, and clothes. However, there is a widespread belief that the life-chances of a child should not depend on the wealth of his parents or the happenstance of the community in which his parents live. The prospect of upward mobility, that one’s children will be better off, has provided much of the political support for public education.

These concerns about “equity” may explain why the government has taken an active role in providing education at the elementary – and secondary – school levels, but they do not fully explain the role of the government in higher education. If capital market were perfect, individuals for whom education is beneficial, for whom the return to education exceeds the cost, have incentive to borrow to finance their higher education. But private lenders are not, for the most part,



willing to lend to finance education. Hence, those without funds of their own (or their parents') would be denied access to higher education without some assistance from government. There is good explanation for this: banks are concerned about the difficulty of getting repaid. The substantial difficulties that the government has had in getting loans to student repaid is consistent with these concerns. Most public support for higher education has taken the form of free, or at least subsidized, education in state universities and colleges.

The concern for equality of opportunity has led to almost universal agreement that the government should play some role in the provision of education. Less certain is what its role should be. The situation is different in every country, but there is common agreement, that the government should try to rationalize the education system, so as to make more efficient. This is the case in CEE as well.

Modernizing the education system means:

- improving its quality and relevance,
- maintaining nursery education, and
- increasing access to upper secondary and higher education

It will have to be achieved:

- through more efficient use of existing public resources and
- by mobilizing other resources.

Key areas are:

- the rationalization of the institutional network,
- further integration of research institutions,
- reorganization of teaching programs and teaching staff, and
- flexible learning arrangements – shorter, evening and correspondence courses.

Because of the substantial private returns to be gained from higher education in the evolving market economy, high education is a target for cost sharing with its consumers. There are various ways to achieve this:

- reducing student stipends and charging a tuition fee, with appropriate funding mechanisms for students from poor families,
- another levying a proportional "graduate income tax" on beneficiaries of publicly-founded higher education once they enter the labor market and begin to reap the benefits (higher incomes) from their education.

But it can not be forgotten that as countries of CEE continue the transition to market economies, the importance of education grows apace; its central role underpinning a successful democracy, in furthering functioning and growing market economy, and in ensuring social equality has to be widely acknowledged.

Reform of the education system has begun in all the CEE countries. The elimination of irrational parallelism and the integration of the institution has begun. Decision-making responsibility for state education and vocational training is divided between central government, local government, and number of different ministries.

Most state education institutions come under the control of local government bodies. The curriculum has been modified according to the new requirements of the market economy. A multi-sector school system – state and private schools – and some elements of a genuine market for professional services have been created. The major source of funds for education is still public, but the role of private funds has been increasing. However, the value of state contribution and financing in real terms remained unchanged or even decreased during the transition period. Due to that, the education sector is underfinanced, especially if we take into consideration the economic and social importance of the educated and skilled population in a competitive modern market economy.

### **Employment Policy and Unemployment**

During the transformation of the planned economy into a market economy, the *labor market has been freed*. Freeing up labor markets means *reducing rigid central controls* on wages and labor movement, while *instituting active labor market policies*, education, training, job information, consulting services, small business assistance, government provided unemployment benefits and new mechanisms for collective bargaining. Among other things, such policies aim to promote efficient labor mobility and to avoid strikes.

Unemployment problems usually are handled by so-called passive and active means. *Passive means* involve unemployment benefits and different social assistance aids, given mainly by local municipalities. *Active means* involve re-education programs, employment creation, creating new jobs, public works, development of regional production-related infrastructures (roads and telecommunication, for example).

In the early part of the 1990s, wage regulation was abolished and now wages are determined mainly by market forces. However, in most of the CEE countries there is a so-called Interest Reconciliation Body consisting of representatives of government employees and trade unions, that advises entrepreneurs and the trade unions as to what wage policy is rational to follow in given situations and sets some guidelines for wage and income policy, for example, by recommending the minimum wage.

Unemployment became a major problem in CEE in the 1990s when the transition started. It generally was suspected that even previously, a significant number of persons had been affected by unemployment, but the phenomenon received no official recognition. Taking this into consideration, the dramatic increase in unemployment rate after 1990 is not quite so shocking. However, the unemployment rate increased in most countries, reaching well above 10%, a high rate even according to international standards. Unemployment in Hungary, for example, increased steadily during the transformation and reached about 10 – 12% of the active population at the end of 1992; in the Baltic countries this figure was about 8 – 10%.

In nearly all the CEE countries, unemployment programs have been undertaken on a new legal basis, since 1991 when laws on unemployment were implemented and unemployment benefits introduced. In early the transformation, unemployment benefits were a large fraction of the recipient's previous wage (often up to 75 percent), and some countries set no time limit on benefits. By 1995, benefits in all the CEE countries were small, largely for fiscal reasons, and some countries, including Hungary and Poland, paid benefits at same flat rate to all recipients. Such an approach simultaneously improves work incentives, minimizes costs, and eases administration. All the CEE countries now generally limit the period over which unemployment benefits are paid to a year or less. Once their entitlement has expired, unemployed workers must rely on poverty relief. The result is a high incidence of poverty among the unemployed in countries where poverty relief is patchy (From Plan to Market. 1996).

The full implementation of the active labor market policy, that is employment services (placement, consulting), "recycling" existing skills more effectively, training to increase human capital, and direct job creation is likely to be beyond the means of CEE countries, except on a small scale and very selectively however, the more developed ones, such as Czech Republic and Hungary, have achieved a quit remarkable results in this area. (From Plan to Market 1996.)

### **Social Exclusion and Poverty**

During the transitional period (since 1990), a growing number of households, including many headed by younger workers, slipp into chronic poverty every year. This was due to the initial decline of economic growth, rising unemployment, shrinking welfare expenditures (in real term) and social transfer, and declining public services. The increase in poverty differs widely from country to country, however. Indeed, in some poverty may already have started to decline. The varying pattern the fall and recovery of output, together with the efficiency with the state provides health and education and the social safety net, have been crucial determinants of the different development of living standards in the transitional countries (Transitional reports 1997). Table 11-2 shows income poverty in selected CEE countries. It should be noted, however that poverty has many dimensions, of which income is only one. It is important to recognize these other dimensions, in particular health and education

Poverty can also be measured also in absolute terms as the share of the population receiving less than the subsistence minimum income. According to this calculation between 1.5 – 2.0 million people in Hungary, about 15% of population were below the poverty line in 1992. This figure reached more than 20% in 1994. This figure was 40% in Belorussia, 20% in Estonia, 80% in Lithuania, 40% in Romania. (Violet Roxin – János Hoós. 1995)

**Table 11-2**  
Inequality and poverty in selected transition economies.

Country	Gini coefficient Change from			Poverty head count <sup>a</sup> Income Expenditure	
	1993	1987 -88	1987 -85	1993	1993
<i>CEE countries</i>					
Bulgaria	34	11	2	33	...
Czech Republic	27	8	0	1	1
Hungary	23	2	1	2	6
Poland	30	5	12	12	12
Slovenia	28	4	0	1	1
<i>Newly Independent states</i>					
Estonia	39*	16	...	23	21
Kyrgyz Republic	about 50	9-33	...	76	57
Russia	48	14-24	...	38	35

*a. Percentage of population below the poverty line.*

*Source: From Plan to Market*

The following types of households are most vulnerable to poverty: single-parent families, households with elderly heads, households containing unemployed persons, households where the working-age head is inactive, households where the head has low education, households having four or more children, and gypsies. There has been shift in poverty from rural old to urban families with young children; away from special occupations to family circumstance, especially unemployment; and away from inactive households to households with active earners.

The key to containing and reducing poverty is continued economic growth. However, for some people, such as those with outdated skills, elderly, and children in large families, growth is not the complete solution. For such groups explicit remedial programs are needed. Even for the rest of the population, growth will need to be sustained to have a major impact on living standards.

Reforms are also needed to correct the perverse redistribution of income, which contributes to this general trend of increasing poverty incidence. Therefore, the final solution for the poverty problem of CEE will be successful social policy reforms and sustainable economic growth.

### **Conclusion: European Union (EU) and Social Policy in CEE**

One of the main priorities of the policy of countries of CEE is to become members of the EU, which for many is expected in 2004. The EU sets requirements – including ones relating to the social policy – for accession. These requirements put emphasis on the reform of social policy. Let us look at two important examples:

In the case of health reform, they are: integration of health contribution collection in the tax authority; completion of the privatization of the practices family doctor; and modification of the system of medicine subsidies. For example, the fixed amount of subsidies has broadened; to start a comprehensive people's health offensive due to deteriorating health condition of the population, decrease of the number of population; to allocate larger resources for health care; the emphasis of public policy should switch from health care to health maintenance.

In the case of pension systems, the objective of pension reform is to give citizens the freedom to decide whether they are satisfied with the pension provided by Social Security, or whether they would like to take on a greater degree of responsibility for their retirement; to establish a "multi-pillar" pension system; strengthen the insurance principle. The countries of CEE that are becoming and to members of the EU – Poland, Hungary, Czech Republic, Slovenia, Estonia, for example, must meet these requirements, and by do so, the reform of social policy will be accelerated in these countries. At the same time, EU membership can strengthen the economic foundation of these countries, allowing them to create and implement an efficient social policy.

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# Chapter 12





# Efficiency Issues in Higher Education 1/

*Dóra Vámos*

Education is a critical issue in the nations of Central and Eastern Europe, particularly the question of funding and distribution systems. Shifting towards normative and market-oriented financing makes experts fear losing quality of services because this type of financing will create conditions typical of market competition, which jeopardises the genuine function and autonomy of universities and accentuates the differences between the famous and prestigious universities and the other institutions.

However, looked at it from another angle, these conditions will enhance the financial autonomy of institutions, and the more independent they are, the more external resources they will be able to obtain for their support. In the Austrian system, for instance, the state provides extraordinary support in a defined rate if a university can obtain external resources. In Spain, state support and the use of external resources is even more interrelated, as the extent of state subsidy is *ab ovo* defined by the extent of external resources.

## **Interpretation of efficiency criteria in higher education**

A service which aims to substantially influence people's lives and fundamentally influence the development level of a nation cannot only be measured by economic indicators. In terms of social welfare, efficiency shows how the system of economic and professional political concepts and conditions can synchronise with each other (to perform necessary and, at the same time, valuable activities with no squandering) while the interests of participants in services and financiers are also taken into account.

In our study "efficiency" is a complex notion far beyond the mere scope of consideration and comparison. Efficiency in our study has two major components. One of them is economy, which synthesizes the costs and the yield; the other is success, which includes performance and effectiveness from the point of view of social demands and development. Restricted economic index numbers can be obtained through cost examinations and efficiency calculations reflect the money used to achieve the results. Calculations of economy cover the costs incurred to obtain a diploma; then, they also cover the question of whether there is return and how long it takes to get the return. In a word, the aim of calculations is to predict the probability and extent of financial profit.

Consequently, economy qualifies on the basis of appropriation assigned to the aims of service: to achieve given and measurable aims from less money or to solve as many tasks as possible from the given money. Clearly, the central role is played by the capital used, which can be utilized in more than one way. The notion of economy is closely related to cost effectiveness, the low or high indicators of which give obvious indications about economy.

In case of a public service, the cost effectiveness indicator will take us closer to the aim of our investigation because in the course of working it out, the result of operation have to be qualified as well. As András Semjén puts it:

*“... for an educational institute the efficiency requirement means that the institution produces a given educational result (output) at minimum costs, which, on the other hand means that the institution produces a maximum educational aspect and result achievable with a given input. Thus, the adequate efficiency of teaching-educating work in the different institutions must be there in the background of the social efficiency of resource-allocation.” (Semjén, 1999/3 575 p)*

The efficiency indicator, which qualifies the educational service, not only uses the measurement of cost effectiveness but it also surpasses it because the efficiency indicator pays particular attention to the examination of results. In addition to examining the performance on the productivity of an institution or chain of institutions, the external effects ensuing during operation also have to be examined the same way as the effects (effectiveness) ensuing later in time after the output.

The effect of higher education can be examined, measured and evaluated at the macro level through the education level of the population (number and rate of graduates), through the labor market position of graduates (graduates' congruency, graduates' joblessness), through the scientific acknowledgement of university and college teachers, and through the change in the demand for higher education.

Institutional effectiveness can be examined on the basis of interest in the given institution, using the number of people who want to get admitted to the institution in the given area or examining employers and families and drawing conclusions from their willingness to make sacrifices. In our view, higher education works well if it is successful, economical and effective at the same time.

In addition to the quantitative features of performance, for the evaluation of success, the qualitative parameters will also have to be measured and considered. Higher education is successful, for example, if it fulfils its objectives as well as possible. It means that besides high standard scientific activity it puts out graduates in a number adequate to the demand. These graduates convey and spread the cultural value requested by the intellectuals and through their individual lives they are also able to set an example for the moral values of society.

In effect, the actual measurement of efficiency can only be done at a later date, after the graduates have started work and when their employers, and colleagues and the graduates themselves can jointly give account of the experience of their adaptation. This process gives actual qualification to the value of degrees and diplomas and this gives informative instructions to the institutions for their development work.

This kind of examination is not yet common. Attempts have been made, however, which are published in the literature both in Hungary and abroad. These attempts suggest that the most viable means of evaluation seem to be the continuous and active relationship between the committee performing accreditations and employers whereby the institutional acceptance, the judgement of institutions and the formulation of efficiency index numbers are all in one hand. In addition to this, intermittent contact may also be necessary between the institutions and employers, which could provide the opportunity for direct coordination and even for cooperative resolutions.

The efficiency examinations at the institutional level require business administration methods. In our view, the methods of the New Institutional Economics work best. This is a new way of thinking. The approach, which can be very well applied to analyze institutions rendering public services at both the macro and micro levels. This trend of economics puts institutions in a central position where they can define the rules of the game and can bring about the stimulus to introduce economical and effective assistance in all the significant areas of the economy and society (Coase, 1966).

The way of thinking professed by the New Institutional Economics is gaining ever-greater acceptance in the area of science.

This branch of science considers institutions as not only *preconditions to be* presented in an exogenous way, but also views them as endogenous factors in a model created specifically for this purpose by using comparative statistical and thereby social-technological means regulated normatively and considers them as developing and dynamic possibilities with enlightening purposes. (Richter, 1994)

The acceptance and dissemination of theories related to the new institutional economics – in analytical relation beyond the discipline, in particular – is subject to the potentials of international research and economic-practical cooperation, which is its weakness and strength at the same time. Its weakness lies in the fact that its central notions and analytical ideas are so bold that they allow generating concepts nearly at discretion. (Confer Schumacher, 1991.) Many people think that this theory has belonged to the scope of heuristics so far, namely it is the logic of forcing scarcity. If looked at from the angle of the other social sciences, it seems to be the implementation of economic imperialism and with some exaggeration, as the danger of suffocation and containment stemming from the economic sciences.

As its system of notions and concepts for analysis is lacking empirical-positive definiteness, this method is open for a great variety of applications in many areas of life; by no means does only the narrowly defined economy belong here. It is suitable for handling the subject of examination in an organised way with the ability to find it any time. The ideas contained in this theory promise well-received criteria, analytical tone-blocks and processes to break up institutions into groups in extremely heterogeneous fields of application, most often in terms of condition dependent generation.

Eventually, this theory seeks to find answers to questions unsolved by the general economic theory. What economic reasons can explain the existence of different institutions? To what extent does the choice of institutional structure affect the economic effectiveness? Its basic idea is extremely simple: establishing and using institutions or organizations incur costs such as *transaction costs*<sup>2/</sup> as a consequence of which the structure of individual *capacity of disposal*<sup>3/</sup> will affect the economic total.

Before going on with this theory, let us examine and discuss another approach to the examination of efficiency, cost-benefit analysis. Is it justified even if we have to quantify values, which may get degraded in such an endeavor? Schumacher described this aversion in the following way:

*“With the method of cost-benefit analysis the economists are getting closer and closer to the attempt to fit the non-economic values in the economic calculations. This method is generally considered an enlightened and progressive breakthrough because at least it makes the attempt to reckon with such costs and benefits, which would otherwise be completely ignored. In reality, however, this method reduces the higher level into a lower level and attributes a price to something, which has none. Therefore, it can in no way help to clear the situation and cannot lead to an enlightened decision. It can lead to nothing else but to self-deception or deceiving others, as it is an impossible undertaking to measure what cannot be measured. It is nothing else but a roundabout way to use ab obo given notions to draw ab obo defined conclusions. In order to obtain the desired result nothing else is needed but to attribute appropriate values to the unmeasurable cost and benefit factors” (Schumacher, 1991. p. 45)*

The inwardness of statements, which seem to be appallingly true at first reading, is undeniable, as it is useless and disdainful indeed to measure the unmeasurable. First, however, it has to be verified that the non-economic stock is really unmeasurable. On the other hand, the unmeasurable can also become tangible – even if not with explicit economic index numbers – with an analytical method describing and typifying the characteristics of the stock.

Finally, the aim-itemised evaluation can also be achieved by linking well quantifiable things. There is no need for attributing “appropriate value”; it only needs sufficient resourcefulness to select the topic of comparison. Taken as a whole, we think that though very difficult, it is not entirely impossible to have an efficiency-oriented approach to different higher educational systems, institutions, or groups of institutions. We also think that it is important and unavoidable to work out the components of scientific value to this approach. If, for some highbrow reasons, we look down on pecuniary valuation, we will give up attempting to demonstrate the economic benefit of public services, conceding loftily the disqualifying blighting of unmeasurable costs and benefits.

## **Factors and development of cost effectiveness through the example of higher education in Hungary**

The basic determinant of the return on input is the volume of the input amount, where volume is a function of the costs. The amount of costs can be influenced from two sides. One of them is the constant cost increasing demand to ensure the success of programs and to extend them and the other is the scarcity of resources and the principle of rationality, which tends to turn down the constantly increasing demands to a pin-point.

The social expenditures amount to about 20% of total cost and to 26% of educational cost. This is a high percentage and plays a role – in a rather uncontrollable way – in making international comparisons difficult. What makes things even worse is that in some places they are entered in the costs of higher education and in some places they are not and they are of high value in certain places while they are negligible in other places.<sup>5/</sup>

Prior to cost examinations, we take the stand that the optimal proportion of GDP for support of higher education cannot be stated. In developed countries this proportion is between 0.8 and 2.5 percent and depends on many factors (e. g. on the efficiency of the operation of organisations and on how individual and other resources are utilized, but none of these factors are of decisive significance). This is clearly illustrated by the example of the USA and Japan, where the proportion of individuals receiving private higher education is high and the involvement of private resources is substantial, but while higher education as a proportion of GDP is high in the USA, it is low in Japan.

In the following paragraphs, we analyze cost effectiveness examinations of Hungary in the past few years. These studies have arrived at different conclusions. While one examination reprimanded the Hungarian higher education for its poor efficiency and suggested that the low level of cost effectiveness is responsible for it (Polónyi, 1996.), another investigation found Hungarian higher education acceptable because it produces reasonable results even with a relatively low basis of assets and finance (Vámos, 1999).

One of the factors responsible for cost effectiveness is one of its components, cost itself. One examination shows that higher education in Hungary is too expensive expenses, another asserts that, higher education is under financed and its operational conditions are too poor to produce high education standards. Using the arguments of the two approaches we are going to utilize the methodology of cost analysis and at the same time, we are going to revise the evaluation of higher education efficiency.

*“The Hungarian higher education and its pertaining economy of the late 1980s and early 1990s can be described as very expensive in terms of specific (unit) price. If the support for higher educational institutions is compared internationally, the proportion of support in the Hungarian higher education (related to GDP and to the state budget) is not lagging*

*behind.” (However, if compared internationally it can also be ascertained that in international practice these proportions of support are sufficient for the education of about double the rate of students (25 – 30%) of the same age-group. In Hungary, however, notwithstanding the increase in the past five years, hardly 15% of the number of an age group study in higher education. This means that in Hungary the rate of budget support for one student that is the GDP proportion is about two or three times higher than in the developed countries”. (Polónyi, 1996 p 32.)*

Undoubtedly, this is the situation if the rates are compared to the GDP and if the *calculated* amount of higher education costs is considered. The picture would be entirely different if a higher GDP could be achieved through business activities and these costs were related to that or perchance net costs were compared to the higher GDP.

Which are then the factors that “determine cost effectiveness”?

- The proportion of students between the *university and non-university spheres* has not been prodigious at all. At the turn of the 1990s, the *rate* of non-university sphere was 43% as compared to 39% in the United Kingdom, 52% in the Netherlands, 45% in Belgium, 27% in Finland, 3% in Italy, 30% in Spain, 38% in Greece and 10% in Portugal during the same period, which shows that no backwardness exists in the structure.
- We are doubtful that the rate of students gaining a degree related to the total number of students is always appropriate for judging and comparing selection during the time of education. Namely, if there is a considerable rise in the number of students in higher educational, the number of graduates will only increase with a lag. Therefore, the number of students cannot be related to number of graduates with the precision that allows drawing consequences. Hungarian higher education based on graduates with degrees was only ranked the tenth in 1993. Its rate of growth, however, was ranked the seventh. If we look at the number of freshmen, this number will even more accentuate the increase of performance taking place in the early 1990s.
- *The rate of the number of lecturers to the number of students* indicates the efficiency of lecturers. When Hungarian higher education is compared, this indicator is undeniably low, but this is due to all the factors working against it. One of the factors responsible for the relatively low indicator is the appallingly low pay level prevailing in higher education, which means that lecturers can only be considered as poorly paid part-time employees.

If the salary of lecturers complying with the employment and grading criteria were increased by at least threefold, the lecturers failing qualification would most certainly be encouraged to get the qualification they need to leave their jobs and give their places to young people who have adequate standards.

In order to show how low the efficiency indicator is, we have to more thoroughly assess the international comparison. Specifically, there are differences in the content of data for different countries. (The notion “education staff” is not defined in the same way. In Hungary, for example, everybody teaching in higher education is included in the staff number, but this number is computed differently in each country. In some countries, for instance, only those with qualification are taken into account.)

The structure of education also affects the number of lecturers. Obviously, seminars or lectures for small groups require more lecturers. If in a higher educational institution there is one lecturer for a course with 2 lectures per week and seminars are in charge of doctorands, education can be performed with many fewer lecturers.

The continuous increase in the indicator referred to earlier will never happen; the increase will halt after reaching an optimum. There are intermittent fluctuations of technical type: the burden will temporarily grow where the number of students takes a jump upwards and the number of lecturers does not immediately follow it. <sup>6/</sup>

**Table 12-1**

Number of lecturers and students in the Hungarian higher education

Year	Number of lecturers (in thousand)	Rate of increase compared to the previous year, %	Number of full time students (in thousand)	Lecturer-Student ratio (5)
1991	17.5	-	83.2	4,8
1992	17.7	0	92.3	5.2
1993	18.7	7	103.7	5.6
1994	19.1	2	116.4	6.1
1995	18.1	-5	129.5	7.2
1996	19.3	7	142.0	7.4
1997	19.7	2	152.9	7.7
1998	21.3	8	163.1	7.7
1999	21.2	-1	171.6	8.1

Source: *Polónyi, 1996. P 26. and Ministry of Education*

The level of pay rate in higher education is undoubtedly low, restricting the efficiency of services to at a level that is backward, and lagging behind. Even if we take into consideration recent corrections that are attempting to reverse this tendency, there is no guarantee whatsoever that the modest growth will reach the threshold value in time to trigger the changes.

*Ways of measuring performance*

The process of analysis has already demonstrated that one of the quantitative indicators of performance in higher educational institutions should be higher. This number revealed what proportion of the population that is most suitable for education actually receives the service. In our case, the responsibility for this number does not lie with the higher education because it is known that in Hungary admittance to higher education has been based on (education) policy decision for the past five decades. The number of entrees has been centrally prescribed and approved on the basis of numbers obtained from labor force planning for the long run and broken down by year. The responsibility of higher institutions is to admit the best applicants within the prescribed number permitted. The entrance procedure has been adjusted to this, which allows getting access to higher education in the order of ranking. The actual capacity of acceptance and performance of higher educational system is not really known either.<sup>7/</sup>

If our institutions were completely filled, the question might arise as to whether there would be an increase in the number of unemployed graduates. In this case, the costs of educating these additional student would, in the final analysis, add to useless expences. Therefore, with this “negative efficiency”, the efficiency of the services would diminish. There are different answers to this question.

- The money “down the drain” is *ab ovo* not so much as can be demonstrated when the specific cost is calculated since the specific expenditure calculated on marginal cost is smaller than the case would be if the smaller number of students had been calculated for the not entirely utilised institutions.<sup>8/</sup>
- The necessary limited numbers can only be accepted as a tendency; they are not precise indices. The oversupply of graduates – particularly at a low cost – produces value even if it causes employment difficulties for the society and individual. “The abundance of qualified people” available for society means value as a matter of course; with an enhanced ability of accommodation, an individual can live at a higher cultural level, which always means value for an employer. For example, since an employer can choose from several well qualified experts for positions demanding the highest professional knowledge.
- The essence of the third counter-argument is the following: provided a higher educational institute puts out – for the sake of the highest possible utilisation – oversupply *for a long time*, the operators of the institution can resort to actions to abate the oversupply (such as cutting down on support, merging or restructuring the given institution, etc.). Accommodation to growing demand is also possible in the same way, but only cautiously so as to prevent the actions from crabbing the efficiency of institution.

We can very well follow the structural change taking place as a result of expanding processes at the macro level.



**Table 12-2**  
Trends of change in size and structure of the Hungarian  
higher education (in %)

Name of group of institutions	Distribution of students			Increase in the period
	1987	1994	1999	
Universities (arts and sciences)	20.2	29.3	25.2	233
Technical universities	11.8	15.5	8.8	212
College of fine arts and physical education	2.8	3.2	1.4	184
Agricultural universities	10.0	8.8	10.3	142
Medical and health universities and colleges	12.9	10.3	6.3	129
Teachers training colleges	25.6	17.6	16.9	110
Technical and economic colleges	16.7	15.3	24.4	148
<i>Other</i>	.	.	6.7	.
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>161</b>

Source: MKM Statistical Information, 1995 p. 3. 2000

The change in structure was actually an adjustment to employment conditions. The rate decrease of pedagogues, following the decreasing number of students in public education, is of demographic origin; the moderate increase in the number of health graduates is due to the relatively large supply of medical doctor in Hungary.

The number of students at universities (arts and sciences) grew nearly to two and half times whereas this sphere provides education to 30 percent of students with only minor institution development. The increase is due to the effect of two factors. One is the demand for education in economics, which is reflected by the 265 % increase in the number of students studying economics at university level. Notwithstanding the increase, the chairs of economics selected only one-third of applicants. Another effect can be the high level convertibility of university (arts and sciences) education, which results from favourable labor-market conditions. The increase in rate shows the recognition of this situation. The technical universities also more than doubled the number of students, which follows demands to a lesser degree but happened with nearly no development. All this documents the flexible growth in performance.

The total number of graduates with degree from all the three university types, however, is stagnating. Within this, the number of full time students graduating with degrees went up by 26 % in 1996 compared to 1991. The moderate increase stems from the fact that the effect of the increase in number has not reached the graduating students. (See: figures in Table12-3)

**Table12-3**  
Increase in the ability of supply at higher education  
for full time courses between 1991 and 1996

Item	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Number of graduates	15 963	16 458	16 201	16 223	18 041	20 024	22 147	24 411	25 338	27 049
Number of freshmen	22 662	25 385	30 192	35 005	37 934	42 433	44 695	45 669	48 886	51 586

Source: KSH (Central Statistical Office) *Public education and higher education of academic year 1995/96 and MKM Statistical Information, 1995., 2000.*

The fact that the number of graduates is behind the increase in freshmen also indicates a stronger selection, which can also be judged as a quality improvement. In any case, the increased number of accepted applicants will result in a permanent increase of graduates in the near future.

**Table 12-4**  
Number of higher education graduates with degree in the various courses

Courses	1980	1990	1993	1994	1995	1996	1997	1998	1990
Engineer-economist	158	380	515	808	607	728	617	314	182
Engineer-teacher	113	158	228	148	-	-	-	-	-
Special engineer-special product engineer	1 390	947	632	790	672	760	853	763	813
Special economist	187	530	656	1 141	849	1 133	1 832	2 187	2 465
Special doctor	1 211	1 610	1 897	1 867	1 919	2 194	2 484	2 859	2 390
Special pharmacist	93	141	255	267	266	169	167	180	145
Lawyer specialised	569	727	1 640	2 238	723	654	997*	1 121	1 055
Labor protection	-	19	9	11	32	38	32	6	50
Other	-	43	164	334	671	916	501	777	3 727
<b>Total</b>	<b>3 721</b>	<b>4 555</b>	<b>5 996</b>	<b>7 601</b>	<b>5 739*</b>	<b>6 592</b>	<b>7 483</b>	<b>8 207</b>	<b>10 817</b>

Source: MKM Statistical tables 30 p. 342

\*Without the engineer-teachers

A qualifying factor for higher education is the number of students obtaining a second or special degree; what tendency can be observed in the 1990s as shown in table 12 – 4. The “heaviest” special engineering course of the 1980s seems to

have abated by the 1990s. At the same time, however, the number of students in other courses obtaining a second degree substantially increased.

In the 1990s there was a dynamic growth in the number of engineer-economists and special economists, whose graduating number nearly doubled in the middle of the 1990s as compared to the beginning of the decade. The number of special pharmacists grew in a similar way and the development in the special course on labor protection is also considerable.

### *Performance and quality*

The statistical data of labor markets or application for higher education of today reflect the effects of at least a decade. With certain reservations, both indicators can be quantified. The demand for graduates in the labor market will soon decline. The number of applicants for higher education will soon decline as well, although as present this figure has been continuously growing due to demographic factors (the number of university and college applicants grew by 80% from 1990 to 1995; from 47 thousand to 87 thousand).

The other correlation accentuates quality, which we consider the most important but difficult to measure. Schumacher says that economists using cost-benefit analysis force us into the frame of economic calculations. Adding insult to injury, economists suggest that the money is the highest value (Schumacher, 1991). Schumacher asserts that money is given too high a value when it is used for measuring everything.

What we think important is whether non-economic values can be compared along with economic calculations. The question we ask is the following: what do we call economic value, and if it is *not economic*, why should we want to make calculations with it?

In our opinion, whatever assets and money can be spent on, raises ascertainable demand and allows losing money or becoming rich, is *also* an economic category and represents an economic value.

According to another approach, quality has a price if we assume that the content following from the definition of quality allows this statement (Harvey, 1996) For Harvey the value of higher education traditionally meant *ab ovo* excellent quality. But it could not mean anything else if through a very severe selection, excellent students were educated by the most outstanding scientific experts; their environment was also instrumental in supporting this activity; they were well supplied with libraries and laboratories; and they could also learn from one another. According to the traditional concept, which related the elite to higher education, the good quality of input guaranteed outstanding output, and these together also plate-marked the performance of institutions of higher education.

Harvey is of the opinion that the quality of higher education was good as long as it was required to produce "excellence" and as long as it had to provide outstanding elite education. If quality is converted into value, he says, the require-

ment will be to have as many students pass through the system as possible *at the lowest possible unit price*. The consequence of these two requirements a mass influx into higher education and withholding money will deteriorate the quality because it will cause scientific thinking to fall into the background.

In our opinion, the cause of concern is not the fact that quality is converted into money. The cause of concern is when qualitative, pecuniary and economic values are pushed into the forefront. The system will then not be able to set off or control the quantitative and cost control aspects. This approach can prevail for a while but because quality is an absolute value, we can also reckon with its renaissance in the course of development. Thus, quality is not reduced because it is expressed in terms of money but for other reasons namely, excessive frugality or negligence or the lack of money or seeking extra profit.

Obviously, it is impossible to expect the same quality from less money. If a country makes the decision that it does not have enough money for the operation of higher education than it should provide it on a smaller scale and send, for example, the students in certain vocational training or areas to another country. Certainly, it should not demand high quality work in exchange for scarce support. Moreover, the country should give credit to those who make every effort to use their utmost talent under miserable conditions. On the other hand, if a lot of money is spent on something, it will not necessary result in good quality. It only provides the *possibility* of reaching higher quality.

*“The nature of the word ‘quality’ means something good and this concept has become something that is handled with some suspicion from the very outset. Quality, to put it plainly, has become the legitimacy of the most deceitful management attitude. It hushes up the under-financed nature of mass educational system, it starts bullying and it entails bureaucratic accountability” (Harvey, 1996. p. 23)*

For Harvey, quality is not so much the result of educational service and it does not refer to the capacity for action by graduates or even to the effects which higher education can exert through these graduates. Performance for Harvey is the *whole process* leading to gaining a degree. He says, it will naturally define the quality of output. “Education is not some sort of service for the customer (still less a product for consumption) but it is a transforming process a participant in education comes to pass.” He says that the essence of higher education is the transformation of students that occurs when they take part in education. Therefore, the transforming quality of education has to be examined, and it has two components. “It is the development of capacities, skills and capabilities and to enhance the competence, creativity and value of participants in general”. So the quality of education can never reach the level of absolute perfection because stressing faultlessness cannot be applied to the process of learning and to the development of knowledge. All this

comes from the fact that "... the notion of perfection is contrary to the process of transformation". (Harvey, 1997. p. 29 – 30.)

This approach makes us change our way of thinking since it differs in several ways from what we have mentioned so far. We state that education is a service and more than that, it is public service. According to Harvey, it is not a service but "the process of transformation". He differentiates and even separates the performance provided for students from the wholeness of goal since considered that way higher education is a service rendered to the economy, the whole of society, to the individual employers. Out of these Harvey distinguishes and highlights the act of *participation* as providing he momentum transformation, the essence of process and activity. Thus, Harvey implies that if education is done well. That is the process of education-learning is of quality. Then the performance will also be of quality.

Why is education service different from other services? The difference comes from what derives from the essential characteristics of participation; the performance of service activity organically builds into the personality of participants and its existence cannot be separated from them. So the final qualification of performance does not only depend on the work of service provider and the educational institution but it also contains the attitude of participants and their "purchasing ability" as well.<sup>10/</sup>

If the transforming momentum of learning is highlighted and placed in the centre of attention in this way, higher education can be made efficient in the 21<sup>st</sup> century – says Harvey. The students have to be transformed in such a way that they should be innovative, independent and self-supporting in their way of life and work. They should be able to choose the general conditions of their work and more than that, they should also know the limits of these conditions so as to be able to step over these limits.

At the same time, we should also observe the difference:

*"... between the quality peak and the pyramid form. The dialectic transforming attitude to quality will make quality include the criterion for expanding quantity, that is to say the criterion that higher education should be able to take large numbers of students; it can also be influential in getting sufficient financial support; it can organise its work so that its nature should meet the demands of society; .... Its role, autonomy and responsibility should serve the changing demands of students; and vice versa: quality should also have a certain reaction to all this. Thus, improving quality is not a sort of game but it is a process which is function of forming the new higher education concept". (Harvey, 1997. 1997 p. 31)*

The transforming quality placed in the centre of reforms can be present in several operating models and Harvey does not say that only one of them is good.

The Welsh model harps on the shackles of accountability, so it stresses autonomous operation for implementing quality learning. The slogan of the Swedish reform in 1993 was “liberty for quality”, under the auspices of which the government passed its authority over higher education to the universities and colleges together with the addition that “...increased the responsibility of institutions in quality assurance and accountability”. The Swedish model suggests that we had better take a bottom-to-top rather than a top-to-bottom approach. Thereby, it encourages individuals at every level to show initiative, rather than spending their time passively waiting for the instructions of management. In Sweden the improvement of quality “... the building of quality starts at the beginning and it is not simply a sort of addition in the form of spreading the good practice .... The emphasis should rather be placed on the internal development processes and not on comparison with other institutions”. (Harvey, 1997. p 31)

Can a due diligence of the institution give a true picture about the education-learning process? Due diligence is a static snapshot therefore, it only allows for comparison. In order to grasp the complete process more than due diligence at several points in time should be analyzed and evaluated in an integrated way. What methods are suitable for supervision? Is external or internal supervision more suitable for meeting the requirements of quality education?

At any rate, the attitude advocated by Harvey puts a very emphatic stress on the *content element of work carried on in institutions*. As a matter of fact, he puts it back in the center. What is in the heads becomes more important than what is in the report books. For this purpose, comprehensive educational aims should be worked out at the level of institution, chair, and discipline. How much of it is to be realised by different courses. In addition to this, the impact that different courses exert should also be worked out on the development of personality should be defined and how different courses should be put together to achieve the desired total effect and to bring about the desired synergy should be determined.

## Conclusion

Now we can turn back to our starting point: is there a correlation between quality and money? If we concentrate on the essence of service, on education and on its quality, we can see how decisive its conditions are. Under a certain level of general conditions, we cannot even talk about the desired workshop or the development of abilities, skills and capabilities which graduates should possess: scientific absorption, practice-orientation, comprehensive knowledge and a lot more.<sup>11/</sup> The relevant question to be asked will not be how much a diploma costs but what is needed for quality work and how and where this can be achieved about.

## Notes

- 1/ OTKA, T No. 032916 in the framework of supported research
- 2/ *Transaction costs* as phenomenon have been known for a long time. Recognising their significance and analysing them in a thorough way, however, is only

spreading with this method. In a very simplified fashion, transaction costs are costs incurred under necessity by the operation and maintenance of an economic organisation. These are the stand-by, usage, maintenance and restructuring costs of the given institution or institutions. Typical examples for transaction costs are costs in connection with the usage of some market (the expenses of signing contracts, demand and information costs, costs of negotiation and decision making, and costs of controlling), or the costs of a relationship with some non-industrial organisation (services, management, information processing, etc.)

- 3/ *Capacity of disposal* has two meanings and is always individual-related. On the one hand, it is the capacity of disposal of those who operate an institution. On the other hand, it is the capacity of disposal over the resources used. And even if they are in state ownership, in the final analysis it will be actual individuals who will dispose over the ways of operation. The activities of individuals with the capacity of disposal are regulated by rules and regulations (constitution, law, contract, articles of association, rules of duty, domestic order, instructions, etc.) and the legitimacy of order is guaranteed or purely internally determined (of Church) or set up coerced by possible external circumstances (animadversion, legal coercion). Individuals with the capacity of disposal can (generally) behave reasonably, or in the sense of full or restricted rationality, which means that the individuals make efforts to make the best of the institution.
- 4/ The institutional chain cost examination of higher education was prepared in 1989 for the year 1987. (See details: Vámos, 1993)
- 5/ The community and individual costs of the operation of higher education and the costs to those of participating in it can be examined by three approaches:
  - The amount of direct (explicit) costs equals the value of resources used by the institute. One cost component is capital asset such as the costs of buildings, teaching materials, electric power, heating, etc. Another cost component is the payments for lecturers, clerical workers, business staff and other auxiliary staff. The direct costs for students are the costs of travelling, articles for teaching, and tuition fee.
  - Indirect (implicit) costs are understood as the opportunity cost, that one incurs by choosing studying instead of working. In this case, the society relinquishes the goods and services that might result from the missed activity of students and the students relinquish the potential income that would have been received from the work they would have performed during the time of studying.
  - Psychological costs are generated by the tiring and burdening process of studying and by the stress of taking examinations.
- 6/ See the case of Austria, where the number of students increased to one and half times higher in the 1980s and the number of lecturers remained nearly the same. Then, in the following 3 years the number of students increased by 10 percentage point and the number of lecturers went up by 170 percent

Therefore, the indicator got back to the level of the 1980s (9. 7; 14. 1; 9. 4). A similar occurrence took place in Finland. In the United States, the indicator of the degree of supply (that is efficiency) went down from 30.5 percent to 16 – 17% during the 1980s. The load on lecturers is continuously high and even growing in Australia and in Italy ; in Norway, a slow increase can be observed.

- 7/ There was no word mentioned about the really economic aspect, which asks the question if the same set of vessels – with no additional investment – could take more people. As far as we know, the comprehensive capacity of acceptance of institutions – based on qualifying the personal and material conditions – has not been assessed in the past five decades. That is to say, there has been no determination of how many students taught with certain educational methods can use the existing buildings or of how many students the employed teaching staff could potentially educate and train of full utilisation of capacity. In our opinion, the proposition that “The more students there are, the more lecturers, classrooms, material of teaching, etc. are needed” is not true (Zsámboki, 1996). It is possible to calculate how many students can study in the same year and what should be the number of groups or study circles if education is organised with the smallest possible specific cost. Since fixed general costs will decrease proportionately with the higher utilisation (clerical work, heating, lights, cleaning, etc.), direct costs will only grow up to the marginal costs and then they stop increasing. When the institutions decide in a sovereign way how many students they can take and when they can charge as much fee as they think reasonable and collectable, we will be able to form a real judgement of their productivity.
- 8/ Let the annual marginal cost of the education of an economist be 400 thousand forints. If, however, we calculate with the present utilisation, the cost of education will be 600 thousand forints. Thus, with a two-thirds utilisation the cost of education for the society will be just as much – in our case 80 million forints – as if another 667 students were educated.
- 9/ We all know that the degrees are marked: is it true that an institution constitutes a higher quality if it issues more degrees with good marks? Or: a university degree generally constitutes a higher quality than a college diploma – which, by the way, can also be expressed in terms of money – the former, however, does not always imply a higher salary (e.g. the case of medical doctors and teachers in Hungary in the past 4 or 5 decades).
- 10/ Naturally, this correlation is also valid for services of health, fitness, cultural habits and religious life: both the transformation in a way or in another and the fact that the service builds in the personality organically and inseparably. Notwithstanding all this, a service remains a service and as such it is done for the sake of public. Thus, it makes the public richer, the public needs it, therefore it is public service. It is public service even if the essence of its activity is not the moment of output itself, which would present this sphere



as a quasi producer, and not even the acquisition of diploma, for which the process of education-learning is performed but just the opposite. The priority is with the process of transformation and this is education and this leads to the acquisition of diploma and the “making” of different experts.

- 11/ There is scientific evidence to support that certain skills and abilities can only be developed at a certain age. (Management skills, speechcraft, independent judgement, understanding and enjoying music, etc.) If these skills are not developed at the given age, they are unlikely to ever be realized. Therefore, to include it in the educational program, it will need additional expenditure. How could we express in numbers the missed opportunity when we want to support a program with reasons? Naturally, the reasons for the cost element can only be articulated in words, which could become an attribute to the approach of expenditure return indeed.

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# Chapter 13



# **Health Care in Central and Eastern Europe**

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Prior to 1989, quality assurance was not formally present in the health care system in Hungary, largely due to political reasons. Since 1990, however, a major change has come about in the development of quality assurance. In the 1990's several government resolutions, decrees and orders dealt with quality of health care. The government declared its intention to address the quality issue as a factor of decisive importance in the development of the national economy as well as in health care. As required by the 'Act 154 of 1997 on Health Care' today, quality assurance is increasingly present in the daily work of the Hungarian hospitals and other health care settings. This chapter summarises the history of quality assurance in Hungary with its milestones and achievements since 1948, with particular emphasis on: government regulation and legislation; the role of health care professionals; quality assurance in hospitals; as well as licensing and certification of health care organizations.

## **History of Quality Assurance in Health Care 1948 – 1990**

In the socialist era, the quality of health care in Hungary was declared by the communist party and the governments as the best in the world and it was so enacted (e. g. that the quality of socialist health care was the best in the world). As a result, there was no way to investigate or analyze the quality of the 'health services of the best quality'. Reerink (1992) saw the situation correctly when he wrote that: "Formal quality assurance programs were not possible under former socialist governments for ideological reasons." Not only was it not allowed to criticize the quality of health care, but it was not possible to analyze and investigate it either, as data that would have enabled such analyses were partly non-accessible, partly non usable for researchers (e. g. patient turnover data, comparable data on mortality or morbidity by age groups, on equity etc.). This situation was described by Reerink as follows (1991): "The introduction of quality assurance in any sector of health care should never be a single event, a solo action by an interested party; many more elements must be taken into account, acted on and attuned to the common goal of improving the quality of health care delivery."

During the entire socialist era, there was one single and exceptional opportunity for introducing quality assurance in Hungary, between 1968 and 1971, in the course of what was known as the 'New Economic Mechanism'. During these years in Hungary, reformers enjoying the support of the Communist Party worked for the stepwise introduction of the fundamentals of a market economy (social market economy). The reform of services, including the health care system, was high on the agenda. The plans can be characterized by a statement of the committee in charge of the long-term conceptual issues and objectives of the healthcare system,

which although not using the terms ‘quality’ or ‘quality assurance’, still formulated the goals of quality assurance:

*“While further developing the theoretical and clinical research activities that have become established and have been practised successfully, there is a need to attach much greater importance to developing research into such topics of outstanding significance as healthcare organization, social medicine, health economics as well as medical sociology. Only the successful pursuit of these disciplines will ensure the implementation of the current standards of medicine in the quickest possible manner and in the broadest scope, and in the most effective and cost-efficient way, which would at the same time meet the population’s expectations to the fullest possible extent.” (ÉTTB, 1970)*

After a brief halt in 1972, the 1968 economic and social reforms were followed by an almost complete rearrangement: Together with many other things, the healthcare reform and the issue of quality were taken off the agenda, until the mid-eighties. The then Ministry of Health and Social Affairs created a Task Force on Healthcare Reforms in 1987 which started elaborating the reforms in the health care sector. However, this organization was unable to produce achievements until the change of the political system in 1990, and then ceased to exist.

### **Quality Assurance in Health Care 1991 – 2000**

After the political changes in the early 90s quality assurance activities started to mushroom and were assisted by the government, funding agencies, providers and patient organizations. (Ajtkay, 1992; Agócs, 1992; Gulácsi, Balitzky, 1992/1 – 2; Gulácsi, 1992; Kiss, 1993; Rubecz, 1993; Kullmann, 1993; Kincses, 1993; Gulácsi, 1993/1 – 4; Gulácsi, Szloboda, 1993; Gulácsi, 1994/1 – 3; Gulácsi, Kovács, Janeski, 1994; Élő, 1995; Goshine Manno, 1995; Andréka, 1995; Varga, 1995; Simon Kis, Bolváry, Dárday, et al. 1995; Simay, 1995; Angelus, 1996; Bugovics and Pilt, 1996; Tamás, Bugovics, Benkő, et al. 1997; Gulácsi and Kovács, 1997; Kincses, 1998; Lukács, Fónyad 1998; Endrőczy, 1998; Bordás, 1998; Szabadfalvi, 1998; Tóth – Daru, 1998; Uhrik, 1998; Simon Kiss, 2000) Table 13–1 shows the chronology of the legislation on quality assurance, 1990 – 1998.

#### *Quality Assurance and Government Programs*

In the 1990’s several government resolutions dealt with quality (3495/1990, 3545/1992, 2006/1993). The government declared its intention to address the quality issue as a factor of decisive importance in the development of national economy. Furthermore, as the protection of life, health, work and environment was considered to be among the fundamental responsibilities of the government, a National Quality Program would have to be formulated and the legal framework for a national accreditation system should be created. In a working paper drawn up jointly with consultants of the International Monetary Fund, the word quality is mentioned

**Table 13-1**

Chronology of the legislation on quality assurance; developments related to quality, quality assurance and accreditation in Hungary

- 49/1990. (IX. 15.) Government Decree on the scope of responsibilities and powers of the Minister of Welfare
- 21/1994. (XI. 23.) Order of the Minister of Welfare concerning the mandatory implementation of national standards
- 1107/1994. (XI. 23.) Government decision on the Government's Program of Action in the Field of Health Care
- 16/1995. (IV. 13.) Order of the Minister of Welfare concerning the colleges in various medical disciplines
- Act 28 of 1995 concerning national standardisation
- Act 29 of 1995 concerning the accreditation of laboratories of certification and supervisory agencies
- 5/1996. (II. 27.) Order of the Minister of Welfare concerning the amendment of Order 21/1994. (XI. 23.) of the Minister of Welfare on the mandatory implementation of national standards
- Act 63 of 1996. Concerning the obligation to provide health care concerning the regional financing normative
- 113/1996. Government Decree concerning Licensure entitling to deliver health services
- 1996 National Quality Award (EFQM), Government Decree
- 1996 Responsibility of Health Care Provision and Territorial capacity Stands of Provision Act
- 19/1996. Order of the Minister of Welfare concerning the minimum requirements of operation to be met by specific institutions delivering health services
- Act 154 of 1997 on Health Care
- 21/1998. (IV/03) Order of the Minister of Health concerning the minimum requirements of operation to be met by specific institutions delivering health services

once in the following context: "Users do not have any incentives in the efficient use of resources, or in assuming responsibility for their decisions, since practically everything can be accessed free of charge, with the sole exception of gratitude moneys given for quality services." (IMF, 1990) Surprisingly enough, neither the Task Force on Healthcare Reform, nor the World Bank consultants addressed the need for quality and quality assurance.

In 1991, the Ministry of Welfare established its Quality and Accreditation Board. The objective with creating this Board was to assist the health administration in formulating quality policies in the health sector, in setting up a quality assurance system in health care that would be co-ordinated with the national and other departmental quality assurance systems. The need for quality assurance is first articulated in Chapter 7 of the Program of Action of the Ministry of Welfare

in 1991. Entitled ‘Quality control, quality assurance’, Chapter 7 points out the followings:

*“At the highest level the state is responsible for specifying the set of requirements (manpower and facilities) of health care as well as supervising the work of the health care professionals. This activity is directed by the Ministry of Welfare through the National Public Health and Medical Officers Service, relying on the experience and activity of the national institutes and professional associations to a great extent. Parallel to the state control peer review and audit have to be created in all institutions in order to control the quality of care. The Health Insurance Fund Administration, as the financing agent on behalf of the public, has rights and responsibilities for controlling health care quality. First of all it means administrative control, but it has notable medical professional quality control responsibilities as well. Both the quantity and the quality of health care delivered have to be inspected, and additional attention has to be paid to striking the balance between quality and remuneration the health care organization received.”*

The Action program for renewal of the health care system (1991), Ministry of Welfare (HN-616/91), does not contain the term ‘quality’, ‘improved health care’ is expected as result of the better work of the hospital management, which explains why the need for training in ‘management knowledge’ got the highest priority. The Quality Assurance Department, Ministry of Welfare was created in 1992. The department is working in collaboration with the Council on Quality and Accreditation. An Interdepartmental Committee was established in 1992, and made responsible for identifying governmental responsibilities, inter-ministerial negotiation and co-ordination of quality related activities as well as supervision of implementation. Sectorial quality activities are the responsibility of the sectorial ministers. In the health care sector: “. . . the main goals of the long term policy on quality in health care are to maintain life expectancy and health status at a high level, to prevent diseases, to ensure optimal treatment, nursing and care in case of diseases and disabilities with appropriate quality.” In reality, peer-review and audit have not been created so far, no state control on quality of care and national institutes and professional associations have had a very limited activities in this field in the past decade.

The activities of National Public Health and Medical Officers Service (ÁNTSZ) in association to the quality of health care remained very restricted due to the very limited input from professional colleges and national institutes based upon the activities of the ÁNTSZ was supposed to be set up. It should be also mentioned that the Health Insurance Fund Administration has not created its policy and activity function to control quality of care on behalf of the public yet.



In his book Ajkay (1994) published a consensus statement of the Hungarian Social Insurance and devoted an entire chapter (Chapter 3) to quality assurance. In the chapter on "The role of the health insurance in implementing quality assurance" Ajkay pointed out that the quality assurance and continuous quality improvement are both the interest of the National Insurance Fund and the population. Poor quality delays the recovery of the patients, and requires additional financial resources and probably cause harm for the patients in somatic and psychiatric terms as well. Quality assurance is an important part of the health care reform, and important for the insurance agency. Booming development of the available medical technology and very often controversial information on the benefit achievable or achieved in using these pieces of technology demand that quality assurance synthesises, as well as the growing (sub)specialisation in the health care. Ajkay argued that economic constraints support the full implementation of the quality assurance as well and the lack of resources might help create interest in quality, and the professional societies showed significant interest in quality. He further explained that it is not useful to create legal regulation too early, what is needed is not legal or regulatory action, but multiple experience. Economic resources have to be concentrated to certain fields where results are highly likely to be visible very quickly. The best way to start quality activities is with small projects in a limited area, where results can be achieved quickly and where even the failure does not stop the quality activities.

#### *Quality Assurance: The Role of Health Care Professionals and the Public*

In June, 1992 the Hungarian Society for Quality Assurance in Health Care was created by hospitals, public health and health insurance institutions, and organised its first conference on Quality in Health Care. As Ajkay (1994) stated: "To serve this goal (e. g. assist quality assurance) the Hungarian Society for Quality Assurance in Health Care was created. This organization, in addition to its theoretical, clearing house and basing functions, started with 5 concrete quality assurance programs in volunteering hospitals in the very same year, as a joint partner in an international co-operation. (e. g. Concerted Action Program on Quality Assurance in European Hospitals, COMAC/HSR) The program contains topics like surgical site infection, antibiotic delivery etc.) This society organised the 1<sup>st</sup> Seminar of the Central and Eastern European Working Party on Quality in Health Care, than took part in a seminar which was organised by the European Council and WHO in Milan. Participants of the seminar launched the San Raffaele Statement, which might determine the future development of quality assurance. (Council of Europe, 1997) In 1993, the leaders of the federation of Hungarian Medical Societies and Associations officially agreed upon the quality assurance targets of the WHO (1992) and signed the 'Recommendations for National Medical Associations Regarding Quality of Care Development' that were endorsed at The European Forum of Medical Associations and WHO, Utrecht (1993). (Worning, Mainz, Klazinga, et al 1993) The WHO Health for All 2000 statements on quality assurance are also relevant to the European context.

There was an interesting situation in 1992 in relation to quality assurance. Quality assurance was not listed among the most important goals of the health care reform. (Surján, 1993) In contrast various professional bodies created their own quality assurance committees at that time. The development of quality assurance proceeded after 1994 as well. In 1995 in the Ministry of Welfare, a Department of Health Care Planning and Quality was established. In 1995 the National Accreditation Council was set up by Parliament by law. This was the breakthrough on the way of quality improvement in health care, and in many other fields of the economy as well. Also in 1995 the Ministry of Welfare's Quality Improvement Council was founded. The opinion of Tekeres (deputy president of the Federation of Hungarian Medical Societies and Associations, MOTESZ) was quite relevant to show the way of thinking of professionals about the quality assurance in 1995: "Quality assurance basically contains two elements: the medical equipment and infrastructure of the given health care organization and the staff. Nowadays the medical equipment has absolute priority which determine the quality of care." (Tekeres, 1995)

At the macro level, besides the government, insurers and professions, the public as users and owners of a public service are key players, their human rights, complaints, advocacy and litigation have to be taken into consideration. The better educated and informed public are more and more demanding for better quality health care services, that is why the general public are not only 'key players' but might be among the most important change agents of the improvement of the quality of care.

### *Quality Assurance in Hospitals*

In Hungary, the development of quality assurance activities has been clearly visible since 1992. In 1992 there were no hospitals with quality assurance policy, no activities that were named or labelled as such, and there were no staff paid for doing quality assurance. While in 1992 the methods and terminology of quality assurance were unknown in the Hungarian hospitals in 2000 lots of them have quality assurance (deputy) director, or co-ordinator, quality assurance committee or at least one physician or nurse whose working time is partly or fully devoted to quality assurance. In 2000, 30 – 40 % of the Hungarian hospitals had some kind of quality assurance activities implemented, mainly an ISO 9000 quality system.

### *European Concerted Action Programs on Quality Assurance in Hungarian Hospitals*

Hungarian hospitals started to implement quality assurance programs in 1992 when a group of 17 hospitals became involved in the first phase of the European Concerted Action Program on Quality Assurance in Hospitals (COMAC/HSR/QA). In the second phase of this program, (BIOMED/PECO) – started in 1994 and finished in 1997 – 20 Hungarian hospitals were participating. (This project was a part of the Medical and Health Research Co-ordination Program of the European Commission; the project in Hungary was partly financed by the Dutch Ministry of

Health, Welfare and Sport.) From 14 European countries, mainly member states of the European Union, 267 hospitals participated in the COMAC/HSR/QA program and 198 hospitals participated in the BIOMED/PECO program. (Klazinga, 1994; Gulácsi and Kovács, 1997) These programs were multi-centre comparative studies on different quality assurance strategies and their effect on improvement of care with respect to: a) preoperative assessment in surgery; b) prevention and treatment of bedsores; c) keeping patients record; d) prophylactic antibiotic use in surgery; e) quality assurance in blood transfusion; f) quality assurance in accident and emergency setting. In Hungary an patient satisfaction survey was added to these as the 7<sup>th</sup> quality assurance topic, to reflect the demand from the hospitals. European concerted action programs were questionnaire based surveys in which general quality assurance related chapters and questions and specific quality assurance topics related questions were included. The general chapters and questions provided a good opportunity to measure the baseline situation related to quality assurance. The European Concerted Action Programs on Quality Assurance in Hospitals (COMAC/HSR/QA, BIOMED/PECO)', were the biggest multi-hospital quality assurance program in Hungary so far and had a visible impact on the development of quality assurance. (Table13- 2).

In this chapter the development of quality assurance activities is presented based on the findings of these programs in comparison with the results from the hospitals of the developed countries. Although 17 hospitals participated in the first concerted action program and 20 hospitals in the second concerted action program, these hospitals represent one fourth – one third of the total hospital capacity in Hungary.

### *Study Design and Validity*

The study was conducted in three interrelated phases. In 1992/1993 the actual practice was registered in the 17 participating hospitals (Phase 1). There were two follow-up activities subsequently in 1995/96 in 20 hospitals (Phase 2) and in 1997 in 9 hospitals (Phase 3) to detect the changes of the preoperative routine. Same questionnaires were used for the evaluation of the baseline and for the two follow-ups in order to keep the study results comparable. Hospitals, mainly large county public settings with around 1, 500 – 2, 200 beds and municipal/city hospitals with around 200 – 600 bed, participated on a voluntary basis. Questionnaires were distributed to medical directors of 124 Hungarian hospitals in 1993 and in 1995 and distributed to 20 hospitals in 1997. Completed questioners were returned by 17 hospitals (14%) in 1993 by 20 hospitals (16%) in 1995 and 9 hospitals (45% response rate represents 5.3% of the total number of hospitals) completed the questionnaire in 1997. In 1993, 10 out of the 17 were large county hospitals representing 53% of the total number of 19 county hospitals and five hospitals were city hospitals with 200 – 600 beds.

In 1995, 9 out of the 20 hospitals were large county hospitals (47% of the total number of county hospitals) and in 1997, 7 out of the 9 hospitals were county hospitals. Altogether 7 large county hospitals (C7) were participating through the whole

duration of the program, representing 37% – 53% of the county hospitals in the various stages of the study. In this study there was a good representation of the medium care provided by large county hospitals. In Hungary the backbone of the inpatient health care system is the network of the county hospitals, these hospitals were recruited from all parts of Hungary. Results from the study are relevant to these hospitals, but in case of top care national institutions and city hospitals, interpretation of the results should be done with caution.

#### *Policy Issues*

The first study on quality assurance in hospitals (COMAC/HSR) in 1992/1993 showed that there were no quality assurance policy, staff and programs (or at least not named as such) in the Hungarian hospitals. The second study (BIOMED/PECO) demonstrated a completely different situation. According to the 1995/1996 evaluation 45% of the participating hospitals (9 hospitals) had quality assurance policy (CWE\*: 38%), and quality assurance program based on this policy which was created during the initial three years of the study. Four out of the 9 Hungarian hospitals created their quality assurance policy in 1995 and the remaining 5 created it in 1992/1993. All these 9 hospitals attached their quality assurance policy documentation to the study questionnaire and sent to the program committee for investigation. In general it can be concluded that hospital quality assurance policies are more developed in those hospitals where quality assurance committees were present. Seven hospitals (35%) reported that hospital wide quality assurance was discussed at least 4 times by the hospital management during the 4 years prior to the study (CWE: 66%). In hospitals where the management was not willing to spend at least 4 times 30 minutes on quality assurance, there was a lower chance for quality assurance to be established. Six hospitals had mission statements (CWE: 59%) and in two hospitals (10%) specific quality management methods such as Total Quality Management were applied (CWE: 66%).

#### *Organization and Structures*

Seven hospitals (35%) out of the 20 hospitals had committees in which there were representatives of all medical staff, and these committees had at least one meeting per year (CWE: 71%). Table 13 – 2/a shows that, for instance, clinical pathology committees were operational in 10 hospitals (50%) and the same rate was found among the CWE hospitals (51%) as well. There was a significant difference, however, in the frequency of the meetings. In Hungary committees had 2 meetings per a year in general, whereas in a group of CWE hospitals committees met 7 times annually on the average.

Table 13-2/a

Development of quality assurance in Hungarian hospitals between 1992 – 1997: committees; in comparison with a group of European hospitals

Committees	17 Hungarian hospitals (COMAC/ HSR/QA) 1992-1994	267 (*) European hospitals (COMAC/ HSR/QA) 1991-1994	20 Hungarian hospitals (BIOMED/ PECO) 1995-1996	All 198 (**) European hospitals (BIOMED/ PECO) 1994-1996	9 Hungarian hospitals (BIOMED/ PECO) 1997
Autopsy	5%	44%	55% f 2	44% f 6	100%
Hospital infection	0%	90%	60% f 3	76% f 6	100%
Drugs/ Therapeutics	0%	88%	80% f 4	79% f 5	88%
Medical records	0%	63%	55% f 4	48% f 5	100%
Blood transfusion	0%	34%	30% f 4	38% f 3	88%
Tissue removed	0%	31%	20% f 3	23% f 11	50%
Tumor/ Oncology	0%	46%	25% f 6	38% f 8	63%
Medical audit	0%	61%	10% f 2	34% f 6	50%
Hospital utilisation	0%	22%	45% f 3	27% f 6	50%
Risk management	0%	13%	25% f 1	26% f 8	25%
Incident reports	0%	33%	30% f 1	29% f 8	25%
Medical education	0%	67%	45% f 8	56% f 9	88%
Medical staff credentials	0%	22%	45% f 2	18% f 3	50%

(\*) Participating countries and number of hospitals: Austria 14; Belgium 42; Denmark 30; France 11; Germany 13; Greece 8; Ireland 5; Israel 17; Italy 14; The Netherlands 15; Norway 4; Portugal 11; Russia 11; Spain 82; United Kingdom 7; Hungary 17; and Poland 40 hospitals. Source: Concerted Action Program on Quality Assurance in Hospitals; Report of the Evaluation Phase, Utrecht, December 1993

(\*\*) Participating countries and number of hospitals (BIOMED/PECO): Denmark 4; France 5; Germany 15; Greece 1; Hungary 20; Italy 11; Ireland 21; Israel 7; The Netherlands 6; Poland 27; Portugal 8; Russia 14 hospitals; Slovak Republic 2; Spain 50; Switzerland 4; and United Kingdom 3 hospitals.

(f) Annual frequency of the meeting of the committees

Table 13-2/b shows the development of quality assurance in Hungarian hospitals between 1992 – 1997 with particular emphasis on committees in the 7 large county hospitals (C7) participating through the whole duration of the program.

**Table 13-2/b**

Development of quality assurance in Hungarian hospitals between 1992 – 1997: committees; 7 large county hospitals (C7) participating through the whole duration of the program

<b>Committees</b>	<b>1995-1996 (BIOMED/PECO)</b>	<b>1997 (BIOMED/PECO)</b>
Autopsy	100% f 2	100%
Hospital infection	86% f 3	100%
Drugs/Therapeutics	86% f 4	100%
Medical records	86% f 4	100%
Blood transfusion	100% f 4	100%
Tissue removed	43% f 3	71%
Tumor/Oncology	57% f 6	88%
Medical audit	45% f 2	71%
Hospital utilisation	45% f 3	71%
Risk management	28% f 1	29%
Incident reports	28% f 1	29%
Medical education	57% f 8	88%
Medical staff credentials	57% f 2	71%

(f) Annual frequency of the meeting of the committees

Table 13-3/a shows the development of the characteristic features of Quality Assurance in hospitals in Hungary as result of the 1st and 2nd European Concerted Action Program on Quality Assurance in Hospitals.

(\*) *Participating countries and number of hospitals: Austria 14; Belgium 42; Denmark 30; France 11; Germany 13; Greece 8; Ireland 5; Israel 17; Italy 14; The Netherlands 15; Norway 4; Portugal 11; Russia 11; Spain 82; United Kingdom 7; Hungary 17; and Poland 40 hospitals. Source: Concerted Action Program on Quality Assurance in Hospitals; Report of the Evaluation Phase, Utrecht, December 1993*

(\*\*) *Participating countries and number of hospitals (BIOMED/PECO): Denmark 4; France 5; Germany 15; Greece 1; Hungary 20; Italy 11; Ireland 21; Israel 7; The Netherlands 6; Poland 27; Portugal 8; Russia 14; Slovak Republic 2; Spain 50; Switzerland 4; United Kingdom: 3 hospitals.*

**Table 13-3/a**  
 Development of quality assurance in Hungarian hospitals  
 between 1992 – 1997: structure of quality activities; in comparison  
 with a group of European hospitals

<b>Quality assurance in hospitals</b>	<b>17 Hungarian hospitals (COMAC/ HSR/QA) 1992-1994</b>	<b>267 (*) European hospitals (COMAC/ HSR/QA) 1991-1994</b>	<b>20 Hungarian hospitals (BIOMED/ PECO) 1995-1996</b>	<b>All 198 (**) European hospitals (BIOMED/ PECO) 1994-1996</b>	<b>9 Hungarian hospitals (BIOMED/ PECO) 1997</b>
Formally adopted policy papers on QA in the hospital	0%	45%	50%	35%	88%
Mission statement	0%	45%	35%	48%	100%
Formally appointed individuals on QA in the hospital	0%	46%	30%	43%	88%
Special budget On QA in the hospital	0%	15%	15%	14%	25%
Formal report on QA in the hospital	0%	51%	55%	38%	88%
Formal procedure for the handling of patient complaints in the hospital	0%	88%	75%	85%	100%
Participation in regional+ or/and national programs	0%	88%	35%	48%	100%

Table 13-3/b shows the development of quality assurance in 7 large county hospitals (C7) participating through the whole duration of the program between 1992 – 1997: structure of quality activities

**Table 13-3/b**

Development of quality assurance in 7 large county hospitals (C7) participating through the whole duration of the program between 1992 – 1997: structure of quality activities

Quality assurance in hospitals	1992-1994	1995-1996 (BIOMED/PECO)	1997 (BIOMED/PECO)
Formally adopted policy papers on QA in the hospital	0%	88%	100%
Mission statement	0%	100%	100%
Formally appointed individuals on QA in the hospital	0%	35%	100%
Special budget On QA in the hospital	0%	28%	29%
Formal report on QA in the hospital	0%	88%	100%
Formal procedure for the handling of patient complaints in the hospital	0%	88%	100%
Participation in regional or/and national programs	0%	100%	100%

#### *Indicators and Practice Guidelines*

The rate of surgical site infection (SSI) associated with clean wound surgery was known in 9 hospitals (45%) related to the previous year of the study (CWE: 35%). SSI rate was 1.5% on the average, within a range of 0% and 3.6%. In 13 (65%) Hungarian hospitals transfusion complication rate was known (CWE: 60%), in the previous year of the study the average complication rate was 0.23%. Autopsy rate was known in 15 hospitals (75%), the same rate in the group of CWE hospitals was 68%, and during the previous year of the study this rate was 62.35%, varying between 15.9% and 100% from hospital to hospital. The development of quality assurance activities in hospitals can be best shown and characterised with the extent of guideline setting and use of guidelines in daily practice. Table 13 – 4/a shows the change between 1992 and 1997 in the field of clinical guidelines.



Table 13-4/a

Development of quality assurance in Hungarian hospitals between 1992 – 1997: guidelines; in comparison with a group of European hospitals

Guidelines	17	267 (*)	20	All 198 (**)	8
	Hungarian hospitals (COMAC/HSR/QA) 1992-1994	European hospitals (COMAC/HSR/QA) 1991-1994	Hungarian Hospitals (BIOMED/PECO) 1994-1997	European hospitals (BIOMED/PECO) 1994-1996	Hungarian hospitals (BIOMED/PECO) 1997
Infection control (***)	0%	88%	75%	77%	100%
Drug prescribing	0%	76%	80%	67%	88%
Antibiotic use (****)	0%	78%	60%	40%	88%
Prophylactic antibiotic use (*****)	0%	94%	45%	48%	100%
Blood transfusion	0%	66%	75%	64%	50%
Standard blood orders	0%	64%	65%	47%	50%
Medical records	0%	62%	75%	55%	50%
Preoperative assessment (*****)	0%	62%	45%	54%	88%
Prevention and therapy of pressure ulcers (*****)	0%	83%	50%	54%	100%

(\*) Participating countries and number of hospitals: Austria 14; Belgium 42; Denmark 30; France 11; Germany 13; Greece 8; Ireland 5; Israel 17; Italy 14; The Netherlands 15; Norway 4; Portugal 11; Russia 11; Spain 82; United Kingdom 7; Hungary 17; and Poland 40 hospitals. Source: Concerted Action Program on Quality Assurance in Hospitals; Report of the Evaluation Phase, Utrecht, December 1993

(\*\*) Participating countries and number of hospitals (BIOMED/PECO): Denmark 4; France 5; Germany 15; Greece 1; Hungary 20; Italy 11; Ireland 21; Israel 7; The Netherlands 6; Poland 27; Portugal 8; Russia 14; Slovak Republic 2; Spain 50; Switzerland 4; and United Kingdom 3 hospitals.

(\*\*\*) Infection control – county hospitals (C7) participating in the risk-adjusted surgical site infection surveillance program

(\*\*\*\*) *Antibiotic use – assessment and development of antibiotic use in some extent was part of the risk-adjusted surgical site infection surveillance program the risk-adjusted surgical site infection surveillance program*

(\*\*\*\*\*) *Prophylactic antibiotic use – assessment and development of antibiotic use was part of the risk-adjusted surgical site infection surveillance program*

(\*\*\*\*\*) *Preoperative assessment – county hospitals (C7) participating in the preoperative assessment in surgery program*

(\*\*\*\*\*) *Prevention and therapy of pressure ulcers – county hospitals (C7) participating in the prevention and treatment of pressure ulcers program*

There were clinical guidelines in many hospitals in the following fields infection control in 14 hospitals (70%) (CWE: 83%), in 14 hospitals (70%) in drug prescription (CWE: 70%), in 13 hospitals (65%) blood transfusion (CWE: 64%), in 13 hospitals (65%) guideline on blood order was in use (CWE: 40%), in 8 hospitals (68%) preoperative routine (CWE: 54%), in 9 hospitals (45%) prevention and treatment of pressure ulcers (CWE: 68%) Table 13 – 4/b shows the development of quality assurance in 7 large county hospitals (C7) participating through the whole duration of the program, between 1992 – 1997: guidelines

**Table 13-4/b**

Development of quality assurance in 7 large county hospitals (C7) participating through the whole duration of the program, between 1992 – 1997: guidelines

<b>Guidelines</b>	<b>1992-1994 (COMAC/ HSR/QA)</b>	<b>1994-1997 (BIOMED/ PECO)</b>	<b>1997 (BIOMED/ PECO)</b>
Infection control	0%	100%	100%
Drug prescribing	0%	100%	100%
Antibiotic use	0%	100%	100%
Prophylactic antibiotic use	0%	71%	100%
Blood transfusion	0%	71%	71%
Standard blood orders	0%	71%	71%
Medical records	0%	71%	71%
Preoperative assessment	0%	86%	100%
Prevention and therapy of pressure ulcers	0%	86%	100%

*Audit*

Hospitals were asked to identify the body or organization responsible for external audit. Answers were received from 7 hospitals (35%) out of the 20 participating hospitals. Five hospitals named the National Public Health and Medical Officers Service as the most important organization responsible for external audit, through the system of supervising chief physicians on county level who audit hospitals every three months. Three hospitals mentioned public control through the application of patient satisfaction questionnaires. According to one hospital the most important organization doing external audit is the national Health Insurance Fund through DRG financing mechanism and one hospital named the Health Committee of the local municipality as the most important external auditor. One hospital reported that the pathologist employed by the hospital was the person responsible for external audit.

Nine hospitals (45%) had a detailed quality assurance plan or report (hospital wide or for a certain part of the hospital) which consists of specific data related to health care delivery for a given time period (CWE: 40%). Systematic process for measuring patient satisfaction and handling patient complains existed in 14 hospitals (70%) (CWE: 90%). Patient satisfaction surveys with questionnaires were conducted in 10 hospitals (50%) during the year prior to our survey. (CWE: 76%). Reports from 13 (65%) hospitals showed that results of patient satisfaction questionnaires are used in the practice of quality assurance (CWE: 54%). Survey results were discussed in meetings of senior physicians and hospital management, and are used to improve patient information and sometimes to investigate staff responsibility. Two hospitals (10%) reported active co-operation with the representatives of local patient self-help groups and organizations (CWE: 44%). Service for patient information was available in 2 hospitals (10%) where patients received information about their own illnesses, and available therapeutic services (CWE: 27%). Fourteen hospitals (70%) provided information materials regularly to the patients about the services of the given hospital, mode of operation, visiting policies and policies and process of admission (CWE: 83%). Six hospitals (30%) provided written information about certain clinical diseases or status and about their diagnosis and therapy (CWE: 47%).

*Resources*

Resources (e. g. staffing and data) were also investigated as part of the program. According to the result of our survey 5 hospitals employed professionals (in general 2.5 – 5.5 full time equivalent) who received their salary partly and/or fully for working on quality assurance (CWE: 54%). The quality of the study questionnaire and the attached documents about the quality activities of the given hospital seems to be significantly better in the hospitals that employ staff to do quality assurance. Quality staff consists of physicians in all hospitals, nurses in 4 hospitals and managers in 4 hospitals. In 5 hospitals (25%) a separate budget was available

for quality assurance activities (CWE: 19%) Seven hospitals (35%) participated in some kind of regional or national quality assurance program.

Altogether 68% of the nurses working in the group of 20 BIOMED/PECO hospitals were qualified (specialist nurse and midwife), and this rate varies between 42% to 96.2% from hospital to hospital. During the academic year of completing the BIOMED/PECO questionnaire, 9.5% of the nurses took part in postgraduate training courses, and this rate ranged between 0% and 25% among hospitals. In 5 (25%) out of the 20 hospitals nurses formed a special committee where all nurses were represented and these committees met more than 10 times a year (CWE: 77%). Training/education plan for continuous nursing education for nurses was in place in 14 hospitals (70%) in this group (CWE: 71%). In 2 hospitals (10%) there are nurses at department level working on quality assurance according to their job description (CWE: 62%). In 13 hospitals (65%) there are nurses working on quality assurance hospital wide. In 9 hospitals special advisory committees are working in the field of quality in nursing on hospitals level (CWE: 48%), and in two hospitals (10%), committees with the same function exist on department level (CWE: 27%). These committees, both on hospital and department level, deal with surgical wound infection surveillance, patient satisfaction, nursing documentation and the prevention and treatment of bedsores.

Documentation of quality assurance in nursing was received from 6 hospitals (30%). Based on the results of the baseline studies in these hospitals they pointed out the importance of quality assurance activities in the fields of the catering, drug delivery and nursing documentation. They concluded that. . . “in many cases within nursing processes personal responsibilities were not possible to identify, . . . , nursing documentation is very much outdated, incomplete and badly designed. In many cases important pieces of information were lost in the big bulk of papers and in many cases documentation was unnecessarily redundant”. “. . . the results (outcome) of nursing was not thoroughly evaluated.”. . . “nursing and medical documentation overlap to an unnecessary extent (for example in the field of important symptoms, drug treatment, examinations and interventions)”.

In 15 hospitals (75%) out of the participating 20 hospitals a separate documentation centre were found (CWE: 73%), these are integrated patient documents in which all kinds of diagnostic and therapeutic documents of patients are stored together (CWE: 70%). Separate documentation was maintained in 9 hospitals (45%) in the accident and emergency department (CWE: 37%); in 11 hospitals (55%) in special diagnostic departments (CWE: 22%); and in 6 hospitals (30%) in other departments (CWE: 18%). In 10 hospitals (50%) separate documentation is used in the out-patients/ambulatory departments (CWE: 29%). Separate nursing documentation (i. e. separate from the medical record, managed by the medical staff) was operational in every hospital. Guidelines for nursing documentation were used in 11 hospitals (55%) in order to fix the content of the nursing documentation (CWE: 67%). In 10 hospitals (50%) medical staff used guidelines to manage medical documentation (CWE: 54%). The appropriateness of the documentation

(medical records, data collection forms) was checked in 14 hospitals (70%) as well as recording and storing and using the data were supervised (CWE: 49%). Documentation is checked by the head of departments, other department leaders who were appointed to do this job, hospital informatics department of the head of this department, statistician and/or one physician in each department who is responsible, weekly or monthly. In smaller hospitals this was the responsibility of the medical director. Medical Review Committee was working in one hospital.

#### *Quality Assurance in Primary Care and Public Health*

In primary health care quality assurance activities were triggered and heavily assisted with various PHARE funded project and the European Patient's Report on System Performance – EURO PROSPER program in Hungary.

In Hungary quality assurance activities in public health started very early in 1992, with the national infection control program being one of the first quality assurance programs. Due to the legal and regulatory responsibility of the National Public Health and Medical Officers Service in the field of the quality assurance, among others, it was relatively easy to start with this topic, especially because the leaders of the Hungarian quality assurance programs were employed by the public health system. Many hospitals and county public health institutes were involved in the surgical site infection (SSI) surveillance program between 1992 and 1998.

### **Licensing, Certification, and Accreditation of Health Care Organizations**

#### *Minimum Requirements for Hospital Departments*

A Government Decree (113/1996) concerning licensure entitling one to deliver health services was published in 1996. By the invitation of the then Ministry of Welfare in 1995/1996 Professional Colleges set up minimum requirements for health care organizations (hospital departments, out-patient clinics, primary health care organizations) at all levels of the health care services, in terms of facilities, equipment and staff for all clinical specialities. County directorates of the National Public Health and Medical Officers Service are authorised to investigate and judge the conformance of the hospitals with the minimum requirements, through site visits. Table 13 – 5 shows, for instance, that health care provided by 641 health care organizations are categorised into 13, 569 'professional profiles' and 1, 583 out of them received full license. License for a specified time period were given to 414 'professional profiles' and 8, 816 'professional profiles' received temporary license. Almost three thousand (2, 755) 'professional profiles' failed to pass the licensing process.

**Table 13-5**  
Conformance with minimum requirements; licensing of  
'professional profiles', 1997

Health care organizations	Professional profiles (*)	Full licence	Licence for a limited time period	Temporary licence	No licence
Healthcare organizations (**) 641	13,569	1,583	414	8,817	2,755
Independent out patient clinics	11,521	5,849	26	2,611	3,035
PHC (***)	25,239	9,039	542	10,108	5,550

(\*) *The objective of licensing is the 'professional profiles' within the health care institutions/ departments. For instance a department of radiology can provide X-ray, CT, MRI services, but these are different 'professional profiles' with their own minimum requirements. The same can be mentioned in relation to out-patient and primary health care*

(\*\*) *Legal bodies, such as hospitals, nursing homes and other health care institutions*

(\*\*\*) *Family practitioners and other primary health care providers*

Due to the non compliance with minimum requirements most of the 'professional profiles' received temporary licenses. There were almost no hospitals to meet the entire set of minimum requirements. According to the temporary licenses health care organizations (e. g. hospitals) have to meet the minimum requirements related to equipment, machinery and staff till September 30, 2001 and related to building and sanitary engineering of minimum requirements till September, 2005. (21/98 order of the Minister of Health, 1998) Compliance with minimum requirements would cost 32, 095 million HUF at 1997 price on the national level. (32, 095 million HUF is around 280 million NLG. This amount was around 7% of the total health care budget in 1997.) One of the most positive consequences of licensing health care organizations was that hospital management was first confronted with the fact, in a systematic way, that a significant percentage (in some cases the vast majority) of their departments were (and are) not able to meet the basic requirements of the Professional Colleges.

The lack of necessary (minimum) equipment, staff (both in numbers and qualification) and often physical conditions (floor space, structure, lavatories, location) was known before, but in an anecdotal, unstructured way. In 1996 hospital departments were compared to the minimum standards and started to set up a list of non-compliance. Quite often the length of this list became quite impressive in terms of the number of lacking items, and what is more important in terms of money to be invested to meet the minimum requirements. Although temporary license was granted to all hospitals, management is under pressure to

cope with this situation and try to achieve improvement. The appropriateness of the minimum requirements was questioned by many professional organizations and experts, notwithstanding, slow but positive changes might be triggered by enforcing these minimum standards.

There might be some negative consequences of the implementation of the minimum requirements as well. In 1995/1996, no methodological guidance was provided to the Professional Colleges (of which there are 35) to develop minimum requirements (often called minimum standards).

It was not clearly specified whether these standards should be defined as:

- minimum requirements achievable in the short run under the actual conditions of the Hungarian health care system. According to this option management intervention might be necessary, but no significant additional investment is needed.
- statement of expectations should be achieved in the medium run. What should a well functioning organization look like from the point of view of its staff, structure, building, and equipment. Hungarian conditions (structure and actual status of health care organizations, GDP, etc.) should be taken into consideration by this option, but significant further investment are needed.
- the state of the art of the given clinical profession. In this option vaguely defined 'European minimum' requirements should be set, similar to the ones in developed countries, which might be achieved in the longer run, and significant additional investments are needed.

While some Professional Colleges adopted the first option the majority of them opted for the second and third solutions. The process and the main goals of setting minimum requirements were not concerted among Professional Colleges. This resulted in an unfortunate situation, whereby sometimes hospital departments have to satisfy minimum standards reflecting minimum requirements of all three different options discussed above, sometimes in the same hospital. It was also very contradictory that the services to be provided by the specialities/departments were not specified and have not been specified ever since. Rigid minimum requirements for building, equipment and staff on one hand, and the provision of care remained un-addressed on the other, which might have a serious negative impact on quality of care. Another potential problem might be that minimum requirements were set only and exclusively for professional profiles (such as hospital departments) and not for the whole hospital. This might create even more barriers between departments and make the rigid hospital structure even more rigid, according to the Health Care Reform Committee, Ministry of Economic Affairs. (GK, 1999)

Creating 'professional protocols' in local (hospital) levels, within one calendar year, was made mandatory by the first version of the minimum requirements in 1996. The meaning, definition and content of these 'professional protocols' were not explained. No guidance was provided to the health care settings to develop protocols, to prioritise which professional area should be covered, and how, by

whom and when will these protocols be reviewed and inspected. As a consequence of this lacking information and strategy, no hospitals took this requirement seriously. At first the Ministry of Health postponed the deadline by one year, than this part of the minimum requirements was taken out from the second version. After this failure, Professional Colleges were invited to create practice guidelines and protocols, but no methodological guidance was provided to them on this occasion, either. Very few guidelines and protocols were created so far by the Colleges, partly because extra funds and staff were not allocated to them. Practice guidelines and protocols created by Professional Colleges, and was approved by the Ministry of Health, varied in terms of their quality to a large extent, were often contradictory and conflicting, and seldom based on scientific evidence. (GK, 1999) Documentation, periodic review, supervision of practice guidelines and protocols as well as strategy of assisted diffusion and implementation are lacking. As a consequence the impact of practice guidelines and protocols on the behaviour of professionals and the quality of care is insignificant. (GK, 1999) To achieve changes in this field requires well functioning and complex quality management as guidelines are not 'self-implementing'.

The situation is quite similar in primary health care. A so-called 'list of competencies' e. g. minimum requirements for primary care facilities, equipment as well as qualification of the family physicians was set, but on the other side, it was not defined what kind of services and on which quality level, should be provided by the primary health care providers.

### *Certification*

Another interesting phenomenon in Hungary is that 'professional profiles' in almost all certified hospitals (ISO 9001 and ISO 9002) hold only temporary license, due to their incapability to satisfy minimum requirements. According to Varga (1998), president of the Hungarian Hospital Association: in the past some years 48% of the Hungarian hospitals implemented formal quality assurance programs, however, 58% of these activities were devoted exclusively to achieve ISO 9001 and ISO 9002 certification". Since then the tendency is even growing, within one year or two a great number of hospitals will be certified, all county hospitals and large institutions in Budapest included. There is an increasing use of ISO-certification in healthcare to set up the basic principles of quality management. Having developed, implemented and maintained the quality management system it is more than likely that the organization will then seek to have the system registered or certified by an independent third party accredited registration body. Such quality systems are certified following a successful registration audit of the system in question. Certification may be regarded as formal recognition by others of a quality system and that it meets the requirements of a recognised international or national standard. (Sweeney, 1999)

One of the characteristic features of the Hungarian health care system in the current stage of the transition period is a large number of ISO 9000 applications



in the healthcare sector. More than 150 healthcare organizations, such as hospitals (64 settings), out-patient clinics, dental practices and county public health institutes hold ISO 9000 certificate or currently involved in the process to obtain ISO 9001 or ISO 9002 certificate. Recently (September, 2000) one of the four University Hospitals started the application of the ISO 9001 (36 clinics, with more than 2,000 beds). Although no specific guidelines have been developed centrally for the application of ISO 9000 in the acute healthcare sector, its application has been seen country-wide.

ISO 9004 refers only to the aspects of the service industry. As Sweeney (1999) stressed "However, in order to utilise the technical jargon of the standard an interpretation must be made. This appears to have been rectified by three means:

- a) Independent 'Quality Consultants' are creating definitions of the clauses to suit the organization preparing for certification.
- b) National certification/registration bodies developing guidelines for use which organizations must follow in order to be certified by them.
- c) Independent national bodies involved in the development of standards and /or quality programs relating to healthcare have taken it upon themselves to create guidelines for use with ISO 9000."

In Hungary 135 'Quality Consultants' are currently creating definitions and providing assistance for healthcare institutions to prepare quality system for ISO 9001 or ISO 9002 certification. No further efforts were taken to achieve the goal 'b' and 'c' as discussed by Sweeney (1999). There are 42 accredited certification agencies in Hungary, which means that the competition is very high between the agencies. Due to the high competition, certification agencies are not very demanding, and sooner or later, all health care settings will receive ISO certification with 100% or close to 100% compliance who applied for it. No information is available about any failure to pass the certification process.

As mentioned earlier there is no guideline for assisting implementation of ISO 9000 in health care. What makes things even more complicated, provision of health care services (what kind of services should be provided by a given health care setting) is not defined. Practice guidelines, protocols, standards are contradictory, conflicting or lacking (even the terms are not defined). There are no explicit requirements for quality of care, and no required level of quality assurance activities for health care settings. The type and extent of quality assurance depend on the entire management of the given health care organization. For example, infection control, prevention of pressure ulcer, patient satisfaction management were implemented by some ISO 9000 certified hospitals, while others, also ISO 9000 certified, have not implemented quality assurance activities yet. This increasing use of ISO 9000 certification of the Hungarian hospitals might have both a positive impact and negative consequences. In Hungary hospital management mainly consists of qualified physicians and nurses. They went through some limited management training, but in Hungarian hospitals no strong management has been created yet. The positive effect of the ISO-certification could be that the management's attention might be

attracted by the importance of the various parts of ISO 9000 such as: management responsibility, quality system, document & data control, purchasing, process control and other important elements. ISO 9000 quality system probably helps hospitals to set up better hospital administration and management.

There might be potential weak points as well. Probably the most important one among them is that the majority of hospitals do not have well functioning quality improvement committees and sufficient number of quality staff (both in terms of quality and quantity). Quite often quality committees are present, but without budget and authority, and no programs for improvement are set. Hospitals 'buy quality from outside', from the ISO 'Quality Consultants'. The implementation of ISO 9000 is not part of the quality management but it is the only and exclusive activity in the field of quality management in most hospitals. As Klazinga (2000) pointed out: "In general, it does not touch the clinical processes and will address mainly the managerial processes surrounding clinical decision making. It should therefore not come as a surprise that ISO norms are easier to apply to a technical department such as laboratory or radiology department than to clinical department."

There is no nationally set and agreed guide for introducing ISO in hospitals, and it has four further possible negative consequences:

- the whole process is agency driven quality system development instead of a professional driven process,
- the translation of the ISO 9000 standards into hospital management and medical as well as nursing care is also agency driven, there might be significant differences among hospitals. (Guideline for the use of the ISO 9000 series of standards developed locally in one hospital (or in a group of hospitals) maybe contradictory to those used elsewhere. Sweeney (2000) came to a similar conclusion.) The further evaluation of the benefit (or harm) of ISO certification will be extremely difficult because these ISO 9000 based quality systems might show great variations,
- professionals are very reluctant to be involved, they do not speak the very strange language of the ISO 9000,
- according to the ISO 9000, certification may be regarded as formal recognition by others of a quality system and that it meets the requirements of a recognised international or national standard. In Hungary very few standards, professional guidelines and protocols were set and agreed by various professional bodies. Due to the requirements from the ISO agency experts, large numbers of practice guidelines, protocols and other tools for process control were created in the hospitals in isolation, usually within a couple of months' time. Most of them are based on consensus of the staff of the given department, and the scientific evidence behind them is unknown. Their impact on patient outcome, effectiveness and cost-effectiveness were never evaluated, and not known.

The impact of the ISO certification on quality of care and cost-effectiveness is unknown. It could improve quality of care or might cause harm for the patients and increase costs, due to the standardisation of the current practice, which is most

of the time based on practice guidelines and protocols that are company influenced (pharmaceuticals) were never evaluated, and were developed on the national or hospital level. Further research is needed to evaluate the value of ISO certification in healthcare organizations. It has to be pointed out that, in most of the health care organizations which are involved in quality assurance, ISO certification is not just one possible option or part of this activity, but is the only and exclusive activity of quality assurance. In most settings ISO means quality, both for management and for professionals. Currently available information shows that ISO certification is more utilised in Hungary than in other countries, both in absolute and in relative terms. As Heaton (2000) pointed out, that although it is used in many countries, few entire hospitals have applied ISO 9000 standards. In Hungary all 64 settings (more than one third of the total number of hospitals) have applied ISO 9000 standards for the entire hospital.

No study was conducted to investigate this interesting phenomenon, but based on interviews of managers and quality consultants some hypotheses can be established:

- ISO is a widely known and a very attractive concept from the industry. The ISO certification is rapidly growing in the industry in Europe and in Hungary and hospital managers want to follow the example of their industry counterparts and want to achieve similar development in the health care industry,
- In Hungary quality in health care is required by law, (Table 1) but this is an abstract requirement, the 'what' and 'how' as well as the way of investigation or inspection, the relation between quality and reimbursement and other important elements are not described. ISO certification is a relatively easy but visible way (certificate) to show that health care organizations successfully comply with the law.
- To receive ISO certificate is not very expensive (5 – 10 million HUF/hospital depending on the number of beds, 30 million HUF/university hospitals over 2, 000 beds) and the result is attained within 2 years. (No information is available about any organization that failed to pass the certification process) Not much involvement is needed from professionals (they usually keep distance), usually there are one or two part time staff in hospitals who work with quality consultants.
- Hospital management does not need to cope with tensions caused by the reorganization of structure and function of the organization, because this is not needed in order to pass certification process successfully. The interest of various lobby groups in the hospital is not broken and the ISO quality system guarantees the status quo.
- ISO 9000 helps hospital management uncover hidden managerial problems and assists to fix them, according to the hospital managers,
- The value of ISO 9000 certification related to the competition between health-care organizations is unclear. According to hospital managers it has not much importance.

- ISO 9000 certificate and hospital financing is not interrelated according to the interviewed hospital finance directors,
- ISO 9000 could contribute directly to higher income of healthcare organizations. In the western part of Hungary, for instance, lots of dental practices are ISO 9000 certified. These practices are based on Austrian private patients, they prefer dental surgeries with ISO certificate. As many dental practices provide services to Austrian patients covered by health insurance, ISO certificate of the dental surgery is required.

ISO 9000 fundamentally changes focus from outcomes to the management of process. (Hardiman, 1999) That is why ISO might be complementary to the outcome-oriented hospital accreditation schemes. It has a specific relevance to Hungarian health care. Establishing standard and indicator based accreditation scheme might be an effective further development in addition to the existing ISO quality systems in order to improve the quality of care.

The current national quality mentality which is based on regulation and inspection of minimum standards of structure and input and imply that hospitals should move with the times and set up committees and procedures. Similarly to the countries of Western Europe, the next step might be towards performance measured by outcome (clinical, patient perception or staff well-being). However there is an interesting dichotomy growing in western governments about effectiveness of the professional-led developmental and educational approach to quality; they increasingly argue for more transparency and public accountability, even if that means going back to minimum standards and mandatory inspection (Gibbs Brown, 1999) “The external review of hospital quality: a call for greater accountability” in which she also criticises the failure of the JCAHO to safeguard the public interest. There is a continuum between state inspection and internal self-development as tools for quality, and there is continuing debate as to which works better for whom.

#### *Accreditation of Healthcare Organizations*

In the past some years several plans and committees were established to create accreditation of healthcare organizations. However, not much has happened in this field and accreditation of healthcare organizations does not exist in Hungary.

### **Conclusions**

Scientific knowledge is growing rapidly and activities as guideline development and medical audit can help the clinician in reducing the uncertainties that go with practising medicine effectively. Economic constraints to all health care systems force health care providers to be critical on the spending of human and monetary resources. This usually leads to pressure, executed by managers on the care providers, to increase the efficiency of their work.

Quality assurance helps to assure the overall goals of health care; medical effectiveness, patient oriented care and economic efficiency. In the early 1990s quality assurance activities were taken as part of the professionalisation and part

important part of the professional work, but participation was voluntary. In the first part of this decade quality assurance was assisted by decrees and finally quality assurance was made mandatory by Health Care Act. The main objective of the current Health Act, passed in December 1997 and implemented in July 1998 is to set up an appropriate legislative framework for the provision of medical services in Hungary and to define the role and entitlements of all major participants to the sector: patients, medical services providers and the State. This law deal with all important aspects of health care services provision, except financing, quality assurance, effectiveness and cost-effectiveness of services included.

In the near future quality assurance should have a more important role in the following areas:

- *Professional development:* The extent in which professionals can provide an effective answer to patients problems is determined to a large extent by the knowledge and technology available to them. Primarily professional development is determined by the quality of the education. But given the rapid growth and changes in knowledge and technology it is even more important that within the medical and nursing professions mechanisms exist to assure the quality of practice. In most EU countries the medical profession has organised itself as a medical association that has as one of its main tasks to maintain and improve the quality of medical practice.
- *Accreditation of health care facilities:* An accreditation system can be a good mechanism to enhance quality but it should not be used as an instrument to select which hospitals should be closed in a situation of over-capacity. Accreditation is not a replacement for planning.
- *Practice guidelines:* Guideline development programs should combine the evidence-based approach with a stronger focus on involvement of the target groups and inclusion of notions of costs and patient values in the considerations that shape the guideline.
- *Strategy:* There is a need for an implementation strategy to convert findings into action for improvement. Health care professionals and managers have to be convinced of the benefit.

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# Appendix



# The Application of Sociological Methods in Public Policy

*Miroslav Purkrábek*

## An Overview of Methods

Sociology contributes a lot to the development of social theory, methodology of social sciences as well as to social practice. Theoretical findings on bureaucracy, developed by sociologists (Max Weber and others), are often used in public policy thinking. The public policy concepts include social interaction, role, status, social stratification, value orientation, motivation, elite, participation etc. Equally obvious is the application of methodological procedures and sociological tools such as public opinion polls, content analysis, group methods of creative thinking, engaged observation, etc.

In which spheres of public policy is it feasible to apply sociological methods? In general it may be said that where relations between people, institutions are involved, or interactions between public policy participants, communication between them and activities which are strongly socially conditioned or have a major social impact.

From a different perspective, sociological methods play a role in public policy in two important spheres:

- a) *in policy analysis for public policy practice* (policy analysis – Weimer – Vining 1992). They are involved in particular in analyses of the situation for the preparation on decisions about alternative public policy programs, in assessment of the social effects of their implementation, and in stimulating public communication between public policy actors.
- b) *in public policy research*. Here sociological methods are used as a means to investigate public policy as a research object. They participate in the evaluation of effectiveness of public policy processes such as the process of decision making, program preparation, the role of different actors, political elites, citizens, institutions, assessment of the degree of legitimization and support, prestige of institutions and individual subjects etc.

In both instances the application of sociological methods must be consistent with methods of other disciplines used in public policy research. Thus analysis of the legislative process can be combined with sociological analysis of communication between its participants, or the economic cost benefit analysis should be confronted with sociological analysis of the assessment of citizens as regards their social conditions.

It is essential for the successful application of sociological methods in public policy to respect their nature, rules and statistical and sampling procedures and

techniques applied in the proceeding of data. We shall concentrate on those that are according to our experience most suitable for application in public policy.

### *Representative surveys*

One of the frequently used sociological methods is representative *sample survey*, (using population samples, or samples of institutions). As it is not necessary to obtain data about the whole population, in such surveys we can obtain results within several weeks or even days. These surveys are described as empirical or quantitative because they provide information that can be processed by statistical methods. Their advantage is rapid quantitative information, a structured view on the object and an overall analysis, usually of views, opinions and statements of respondents on various issues. Their limitation is that unique phenomena are merged in average values (as a toll to scattered sampling), only superficial attention to systemic relations and inadequate differentiation of the real thoughts of respondents and their answers influenced by many factors that, consistent with statistical laws partly eliminate each other. This type of research is represented most frequently by public opinion polls. The statistical unit in these surveys are usually individual subjects or small groups (family, workplace). In nationwide representative surveys in the U.S. as many as 3000 or more subjects form the representative sample although it is more commonly 600 – 1500; in the Czech Republic with the 10 million inhabitants it may entail 1000 and more. The basis for such surveys is the elaboration of hypotheses and their projection into indicators and questions formulated from them. These questions are addressed to respondents either in an interview or by completing a questionnaire. The analysis is based on an interpretation pattern according to which correlations between variables are tested. This approach is used for example in surveys of election preferences and citizens views on different public issues.

On this basis more “scientific” surveys of public opinion are made, with more differentiated, repeated questions (recording the development of views) and with mirror image questions addressed to different population groups. It makes it possible to compare the views of different public policy actors on the same problems – such a comparison was assessed in a survey of the attitudes of the general public, representatives of local governments and Members of the Parliament in the Czech Republic in 1995.

### *Expert surveys*

These surveys usually investigate the development of a unique public policy, public policy event or process. Here rules of statistical sampling do not hold and experts to be interviewed are selected according to their competence, complemented, if necessary, by other specific requirements. The outcome is typically an in-depth analysis of a particular public policy or at least some of its aspects. Expert surveys may be used to design innovative public policy options as well.

### *Case studies*

These studies are focused on some aspects of social development (dynamic) or situation (static, covering a brief period of time). They analyze certain issue, e.g. privatization of health care, reform of army forces, changes in social security system etc. They use a combination of quantitative and qualitative methods (opinion surveys, analysis of documents, content analysis, statistical analysis and comparative analysis).

In these types of studies various methods are used, however, qualitative methods dominate, supplemented by quantitative methods known from public opinion polls.

### **Analysis of interaction and communication between group members**

uses several research techniques – detailed interview, sociometry, engaged observation and analysis of documents.

### *Content analysis*

was elaborated by B. Berelson (1952) and can be used to assess contents and trends in communication, especially in policy documents, public speeches of politicians or civil servants, programmatic documents, articles in the press and content of other media etc. It is often used for appraisal of values, attitudes and interests, prepared and applied methods of policymaking. It operates with concepts such as recording, context unit, measuring unit and content sorting. This makes it possible to transform qualitative elements of the content into a quantified form to measure their incidence and compare them. This method is often used for the analysis of the election programs of political parties, for analysis of the content of the media and basic documents for decision making. Nowadays, there is available advanced computer software that enables more sophisticated and effective approach to the content analysis of the extensive texts (such as the program package Atlas).

### *Methods of creative thinking*

are used to stimulate and encourage innovative thinking in groups of participants who are experts in different aspects of the given problem. They are used in particular to reveal developmental trends, different solutions, different objectives and problems and assumed costs and benefits of the surveyed programs or policies. They include *brainstorming*, making use of associative thinking in a free discussion to achieve creative suggestions; *brainwriting* (brainstorming in a written form); the *morphological method* based on the breakdown of the analyzed object into elements, properties and their combination which among others leads to the discovery of unexpected alternative solutions; and the *synectic method* involving parallel activity of several groups of specialists using analogies.

### *Biographical analysis*

is suitable for studying the context between the individual subject or typologically selected subjects and social events, political events, living conditions etc. The method is based on Znaniecki's study (1934) and was successfully applied by Janowitz in the analysis of developmental trends of the profile of military commanders from charismatic "heroes" to military specialists and managers (1960). It is suitable for studies of political elites and other actors in public policy.

### *Event analysis (Yamagushi,1991)*

was used above all for warning predictions of events. It was used in a modified form in research of the process of public policy formation at the Faculty of Social Sciences, Charles University in Prague (Purkrábek,1994). The advantage of this method is that it records the dynamics of a given event with regard to the development and implementation of public policy programs and the possibility to evaluate them in context with the appropriate area of public policy and reveal common features of public policy as a whole.

### *Focus group method*

is one of the developing qualitative methods which can be applied with advantage in public policy. Its development was initiated in the 1930s by the prominent sociological theoretician and methodologist P.F. Lazarsfeld. The method was used in particular in research of media and mass communication. Today, it is frequently used in marketing studies. Its basis is selection of a homogeneous small group of respondents (6 to 12 individuals) who can represent demands of the population as regards the given problem. Some firms test before their decision the firm's strategy as regards certain innovations. The essence of the method is a group interview led by the moderator. The group is often exposed to film shots, pictures, diagrams or even certain final products and the participants express their views on them.

## **Application of sociological methods in public policy research**

The application of sociological methods in public policy research is plausible if it complies with the general rules of research methodology. One of the requirements is to combine them, if necessary, with methods of other disciplines, (organizational science, law, economics, public finance, political science, medicine, ecology, ethnology and cultural studies, informatics, criminology, history etc.). Then it is possible to achieve by this procedure the creation of a specific method of public policy as it was the case in the analysis of public events. It comprises sociological procedures but goes beyond them in particular in many other aspects and procedures, especially in analysis of the formation and implementation of public policy. While the outcomes of sociological methods are mainly diagnostic by nature, the outcomes of event analyses pursue program and implementation objectives, i.e., a sort of prevention, therapy, and evaluation within the public policy process.



## **An Example of a Complex Research Methodology**

Take for example the application of sociological methods in public policy research conducted at the Faculty of Social Sciences, Charles University in Prague, Czech Republic in 1994 – 1999.

Czech Republic is a country which, similarly as other CEE countries, does not have an old tradition nor prerequisites of public policy analysis.

The research projects “Analysis of the process of formation and implementation of public policy in the Czech Republic” (1994 – 1996) and “Decision making, communication and financing in public policy in the Czech Republic (1997 – 1999)” were supported by the Grant Agency of the Czech Republic and represented a type of a long – term explorative research the objective of which was to monitor developmental trends arising in public policy, to identify its main problems, barriers and opportunities to develop. It was to a certain extent a step into a confused situation which developed as a result of the penetration of democratic features and public policy institutions into dispersed remains of the old system of state and party control without autonomy of market economy.

The first phase of this research project entailed:

- the introductory study of about 100 pages, evaluating the assembled findings obtained by the method of secondary analysis and the hypotheses of trends and main problems of the functioning of public policy,
- the organization of the research team and definition of the rules of its activities. The team consisted of the three full-time researches and another 21 and later 26 external experts and three MSc. students who acted as research assistants. The research team was multidisciplinary: 13 sociologists, 2 statisticians-sociologists, 1 ecologist, 3 lawyers, 1 economist, 2 historians, 1 political scientist, 3 physicians, 1 education policy specialist, 1 specialist in mass communication, 1 editor and 1 – 3 auxiliary staff.
- the plan of cooperation with other research teams and experts from abroad.
- the development of hypotheses by dimensions, actors and resources (potentials) of public policy:

The study included the following key issues:

- the way how public interests are formulated
- the level of political culture
- the processes of public policy implementation
- the relationship between central government and local self-governments – the level and nature of participation in public policy making
- the application of expert knowledge in public policy making

The study included the following key actors:

- the political parties,
- the government and its institutions
- the self-administration at different levels

- the non-profit organizations
- the mass media
- citizens
- politicians and civil servants

The study considered various resources:

- legal conditions,
- economic resources and their use,
- organizations: their structure and activities,
- human resources (number, structure, qualification, motivation)
- potentials of political participation (experts, citizens)

Conceptual pattern of the application of research methods was also developed: which problems will be investigated by which method and how the findings of different methods will be put together and interpreted.

Two interlinked means of application of research methods were used:

1. The detailed dialogue with public policy actors – empirical research of the attitudes of main actors (citizens, representatives of local administration and Members of Parliament) was conceived as the opinion of each group of actors on other actors and as comparisons of their views and attitudes to identical public policy issues. Empirical research was carried out on representative samples (1007 citizens, 222 representatives of local administration and 146 Members of Parliament).
2. Event analysis in public policy (in 11 areas, a total of 13 events). Examples: the process of privatization of health facilities, introduction of health insurance, social security reform, reform of the army forces,, formation of educational policy, development of the Association for the Protection of Nature, revival of non-profit organizations, churches and religious societies etc.

Analyses of events in public policy were conceived as dominant segments of the evaluated type of public policy. They were thus focused on the development of preparation and implementation of public policy programs oriented either on meeting certain public interests (reform of public health care) or to enforce an instrumental process (privatization of health facilities).

The following stages of public policy events were monitored:

- initial stage (how initiated and by whom)
- type of decision making (quality of preparation and result of decision making etc.)
- extent and operational mode of use of resources (legal environment, financial and human resources etc.).
- the influence of actors on the development of events (support, interference, involvement, in particular influence of the government, political parties, citizens), current and final effects of event (program), in particular the relationship between implemented targets and effects, between targets and methods etc.)

- The conceptual explanatory pattern assumed that the revealed findings would be included in the identification of the synergic effect on public policy as a whole and its individual areas, in time, in social, economic and cultural contexts with the development of Czech society after 1989, and in comparison with findings relating to the same and similar phenomena in Western democracies and in Central and East European countries.

The outcomes of the research included:

- nine proceedings containing theoretical studies, 13 expert analyses of events in public policy and their overall evaluation, interpretations from three empirical surveys, volumes specialized in public policy decision making, communication and financing, study comparing health care insurance systems in several countries etc.
- a monograph written by a member of the team (Potucek 1999).
- a set of articles written by members of the research team in the press and professional journals.
- eight research seminars and two conferences presenting overall results of the research.
- establishment of an archive of research findings as the empirical resource for the discipline.
- utilization of findings of research for Public Policy courses at the Faculty of Social Sciences and for the preparation of Public Policy textbooks.
- dissemination of main research findings among politicians and civil servants (Ministers, Members of Parliament).

The long-term explorative research described above, the objective of which was to monitor developmental trends arising in public policy, created the new tradition of public policy research in the Czech Republic. This tradition is now being utilized and prolonged by the research activities of the Center for Social and Economic Strategies, the forward studies think-tank attached to the Faculty of Social Sciences, Charles University in Prague (<http://ceses.cuni.cz>). Between 2001 and 2003, three comprehensive studies about the country's future opportunities, threats, developmental potentials, priority problems, strategic conceptions and moves were elaborated, published and submit to public discussion (Vize 2001, Průvodce 2002, Putování 2003). Public policy as a discipline provides a solid theoretical and methodological ground for this endeavor – and, by the experience gained during these research activities, is being continuously enriched as well.

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