

# POLITICAL ECONOMY





NEW

SZÉCHENYI PLAN

# POLITICAL ECONOMY

Sponsored by a Grant TÁMOP-4.1.2-08/2/A/KMR-2009-0041

Course Material Developed by Department of Economics,

Faculty of Social Sciences, Eötvös Loránd University Budapest (ELTE)

Department of Economics, Eötvös Loránd University Budapest

Institute of Economics, Hungarian Academy of Sciences

Balassi Kiadó, Budapest



The project is supported  
by the European Union.

National Development Agency  
[www.ujszechenyiterv.gov.hu](http://www.ujszechenyiterv.gov.hu)  
**06 40 638 638**



**HUNGARY'S RENEWAL**



The projects have been supported  
by the European Union.

ELTE Faculty of Social Sciences, Department of Economics

---

# POLITICAL ECONOMY

Authors: Judit Kálmán, Balázs Váradi

Supervised by Balázs Váradi

June 2011

# POLITICAL ECONOMY

## Week 10

### Bureaucracy

Authors: Judit Kálmán, Balázs Váradi

Supervised by Balázs Váradi

# What is it?

- „Bureau” – French for: office
- Salaried people, supplying policy
- What are they after?
- *Power* – a difficult concept. In an uncertain, limited information world, information also generates power.
- Bureaucracy: public (and private)

# What is it (Max Weber)

- Official business is conducted continuously,
  - with strict accordance to the following rules:
    - The duty of each official to do certain types of work is delimited in terms of impersonal criteria..
    - The official is given the authority necessary to carry out his assigned functions.
    - The means of coercion at his disposal are strictly limited and conditions of their use strictly defined.
  - Every official's responsibilities and authority are part of a vertical hierarchy of authority, with respective rights of supervision and appeal.
  - Officials do not own the resources necessary for the performance of their assigned functions but are accountable for their use of these resources.
  - Official and private business and income are strictly separated.
  - Offices cannot be appropriated by their incumbents (inherited, sold, etc.).
  - Official business is conducted on the basis of written documents.
- (Weber 1922, Wikipedia)

# What will salaried managers be after?

- Higher salary, on-the-job consumption, excess staff and emoluments (most of this is positively linked to the size of the budget)
- A lot of that will be linked to the size of the organization under the bureaucrat.
- In a private firm, the profit motive will counterbalance that somewhat.
- There is no profit motive over state bureaucracies.
- And even the output is often not clearly defined.



# Niskanen's model

- Budget  $B(Q)$  (linked to the social utility of the activity) depends on perceived output  $Q$ .  $B' > 0$ ,  $B'' < 0$ .
- The true cost  $C(Q)$  depends on output  $Q$ .  $C' > 0$ ,  $C'' < 0$ . But it is only known to the bureaucrat, not the funding politician.
- The bureaucrat wants as great a  $B$  as possible as long as  $B(Q) - C(Q)$ .
- Thus the bureaucrat maximizes:  $B(Q) + \lambda(B(Q) - C(Q))$  in  $Q$  (\*).
- The funding politician would want to pick a  $Q$  where  $B'(Q) = C'(Q)$ .
- But the first order condition from maximizing (\*) is different! The  $Q$  picked by the bureaucrat will be greater:  $[(1 + \lambda) / \lambda] B'(Q) = C'(Q)$ .

# Other approaches and extensions

- Risk-aversion, etc.
- The informational structure of the politician/sponsor – bureaucrat/agency matters a lot.
- Not a take-it-or-leave it offer but a schedule offered.
- Bilateral bargaining.
- Yardstick competition.

# The lazy (slack-maximizing) bureaucrat

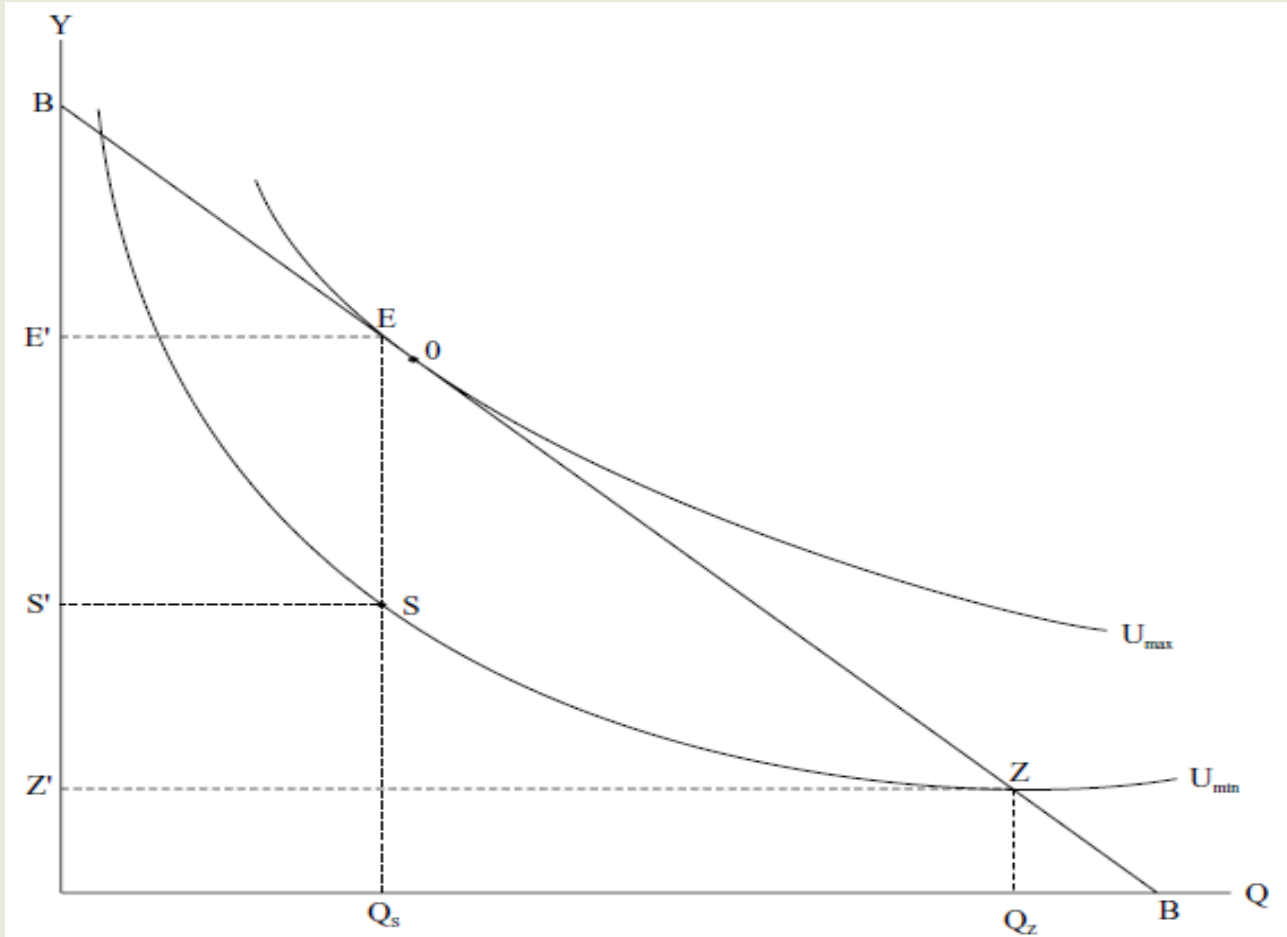


Figure 16.3. The output choice of a slack-maximizing bureau.

# Cost differences between publicly and privately provided services

- Mueller, table 16.1

# The Leviathan hypothesis

- The state (politicians and bureaucrats) do not set redistribution levels at social optimum...
- ...it simply maximizes revenue.
- Normative implications for taxation will be quite different from standard public finance ones.
- A tax can be "too good", distortions might be good, it might be good to tie individual expenditure items and taxes together, etc.

# Leviathan: the evidence

- Is the state like a marketplace,
- or is it an insatiable beast?
- Hard-to-change rules that limit the tax-base produce smaller government.
- E.g. the U.S. state of New Hampshire