

## THE ECONOMIC THEORY OF BUREAUCRACY: INSIGHTS FROM THE NISKANIAN MODEL AND THE MISESIAN APPROACH

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*ABSTRACT:* Governmental interventions in the economy take numerous forms, and they require the existence of a public authority, a bureaucracy, to implement them. This article proposes an analysis of the origins and the dynamics of bureaucracy, and discusses means of escaping bureaucracy's disadvantages. I will proceed by means of a comparison between the theories of Niskanen and Mises, two impressive and very representative works from the Public Choice School and the Austrian School of economics. Although Mises and Niskanen share a common analysis of the defect of bureaucratic management, there are strong disagreements between the two authors about the reasons for the existence of bureaus and about their functioning and their deficiencies. Inevitably, the means proposed by Niskanen and Mises for escaping the disadvantages of bureaucracy are different and can not be reconciled.

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The predominance of the state in our contemporary economies is an important characteristic of the twentieth century. State interventions in the economy take many different forms: taxation, subsidization, prohibition, obligation, restriction of production, monopoly, and inflation (Mises 1998a; Rothbard 1970). Each governmental intervention requires the existence of a public authority, a bureaucracy, in charge of implementing public policy. These organizations are called bureaucracies. They deserve thorough investigation, because of their central role in governmental interventions.

Since Weber's (1952) seminal works,<sup>1</sup> a large literature coming from different fields of investigation has dealt with bureaucracy. The present paper focuses particularly on the reasons for the existence of bureaucracy, its dynamics, and the means of escaping its disadvantages. The analysis proceeds by means of a comparison between the Public Choice approach to the analysis of bureaucracy and the Austrian version, and it aims at understanding the main characteristics of these two alternative theories of bureaucracy.<sup>2</sup> I have chosen to focus on the works of Niskanen and Mises because they are representative of the two schools of thought.<sup>3</sup>

The first part of this paper deals with the reasons for the existence of bureaucracy. According to Niskanen's approach, bureaucracy exists as a result of failures of the market. He proposes a *behavioral* theory of bureaucracy, arguing that bureaucracy functions by circumscribing the effects of incentives inside the organization. In the Misesian framework, bureaucracy is seen as the counterpart of interventionism and of the absence of the profit motive. This approach to bureaucracy rests upon a *praxeological* perspective and aims toward a *praxeological* theory of bureaucracy. The second part of this article will present an analysis of the dynamics of bureaucracy, which Niskanen explained in terms of its organization and which Mises understood as a self-sustained process and an institutional dilemma. The final part of the paper will present the means proposed by both authors of escaping the disadvantages of bureaucracy.

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<sup>1</sup>For a critical assessment from the standpoint of Austrian economics, see Anderson (2004, pp. 1–29).

<sup>2</sup>For a previous work on the differences in logic of these theories and the possibilities of establishing bridges between them, see Carnis (2000, pp. 8–30).

<sup>3</sup>However, other works must not be neglected, particularly Wintrobe (1998) and Tullock (1965).

## I. BUREAUCRACY: THE RESULT OF MARKET FAILURES OR OF GOVERNMENT HINDRANCES?

In Niskanen's view, the bureaus result from the inability of the market to supply certain goods or services. They provide a means of compensating for the deficiencies of the market. Niskanen's approach is essentially concerned with the allocation of resources inside the organization and with the provision of adapted incentives to make bureaucracy efficient. Thus, Niskanen develops a behavioral theory of bureaucracy. According to Mises, bureaucracy appears as the unavoidable outcome of government hindrances of the market process. The main consequence of bureaucracy is the impossibility of economic calculation. Bureaucracy means inefficiency in allocating resources and some hindrances of human plans. Mises emphasizes the praxeological considerations of bureaucratic conduct of affairs and defends a praxeological theory of bureaucracy.

### *a. The Niskanian Perspective: bureaucracy as a result of market failures*

According to Niskanen's analysis, the existence of bureaus is explained by the market's inability to provide goods or services. Bureaucracy is a response to the market's failures. Bureaucracy will exist when the market would not make it possible to achieve some transactions or to satisfy some demands; that is, when the bureau provides greater quantities than those that would be provided by a free market.

Bureaus specialize in providing those goods and services that some people prefer be supplied in larger amounts than would be supplied by their sale at a per-unit rate. (Niskanen 1994, p. 18)

The natural monopoly situation (high fixed costs), the free-riding problem (difficulty in collecting fees), and external effects (difficulties caused by the definition of property rights) imply some difficulties for the market in satisfying the consumer (*ibid.*, p. 19). These are traditional arguments to justify governmental intervention which are defended by the Welfare Economics School of economics (Levêque 1998, pp. 7–10). Niskanen's analysis here seems to be greatly influenced by the welfare economics framework.

In the contemporary environment, when most goods and services that are augmented by collective action are supplied by bureaus, it is often difficult to understand the functional and historical bases for choosing bureaus, rather than profit-seeking organizations, to supply these services. The primary functional reason for choosing bureaus to supply these services, I suspect, is the difficulty of

defining the characteristics of the services sufficiently to contract for their supply. This difficulty leads collective organizations directly to organize the supply of these services, hoping to substitute incentives associated with loyalty to the collective organization for the motivation of profits. (Niskanen 1994, p. 20)

Niskanen goes further by asserting that the bureaucratic system could supply some goods better than the market process does with an alternative way of proceeding. Loyalty would be superior in some ways to the price mechanism, or it is expected to be.<sup>4</sup> It *would* be an appropriate answer to the difficulty to specify the supply of services.

That is a totally different argument from those advanced previously. The above quotation suggests the existence of a gap between the proposed theoretical framework and the historical perspective. An attempt to reconcile the two positions is made by introducing another argument: the difficulty of defining the characteristics of the provided goods and services. However, this argument does not seem well grounded empirically and theoretically. Indeed, there are numerous examples of goods provided by bureaus in spite of their elementary characteristics, whereas there are also many counter-examples of complex products yielded by private firms (Benson 1998, pp. 15 ff.). On theoretical grounds, some academic works have shown that the difficulty of specification would not result from inherent characteristics of the good itself but from public provision of the good (Lipsky 1980).<sup>5</sup>

The peculiarity of bureaucratic provision of goods and services is highlighted by Niskanen's definition, which emphasizes two essential

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<sup>4</sup>Nevertheless, it is not demonstrated how loyalty can be superior to the price incentive and how it can solve market failures. Moreover, this justification of bureaucracy drives Niskanen to inherent contradictions. Indeed, if the bureaucratic process constituted such an adapted mechanism, it would not be necessary to deal with the effects generated by bureaucracy. It is also contradicted by the solutions advanced by Niskanen to fight the negative effects of bureaucracy, which are based on price and market incentives.

<sup>5</sup>In fact, government failures replace market failures.

Street level bureaucrats characteristically work in jobs with conflicting and ambiguous goals. . . . Public service also tends to an idealized dimension that make them difficult to achieve and confusing and complicated to approach. . . . Agency goals may be ambiguous because the conflicts that existed when programs were originally developed were submerged. A typical mechanism of legislative conflict resolution is to pass on intractable conflicts for resolution (or continued irresolution) at the administrative level. (Lipsky 1980, pp. 40–41).

characteristics. “Bureaus are non-profit organizations which are financed, at least in part, by a periodic appropriation or grant” (Niskanen 1994, p. 15). It implies, first, that the difference between costs and revenues is not appropriated by any member of the organization *and*, second, that the revenues of this organization do not derive only from the sales of goods or services. For Niskanen, the appropriate criteria for distinguishing bureaucracy from other forms of organization, and especially from the private firm, are rooted in the fact that bureaucracy does not aim to make a profit. However, Niskanen clearly asserts throughout his book that these characteristics do not prevent economic calculation and the marketing of the product.<sup>6</sup>

Contrary to von Mises’s assertion, bureaus provide many goods and services that can be quite adequately marketed. For centuries bureaus have provided both bread and circuses in various forms, although these products are quite efficiently supplied by profit-seeking organizations—though, possibly, not in adequate amounts. (Ibid, p. 19)

The stakes do not rest in the possibility to determine a price for the valuation of the output but in the understanding of the consequences of the particular production conditions inside the bureaucratic organizations. The value of output can be assessed and the prices can be determined. Economic calculation is not impossible. These latter assertions could be strongly criticized from an Austrian perspective. Indeed, Niskanen assumes the availability of such information and the objective existence of what could be the optimal state of public production, whereas it is entirely impossible to determine what people would like because no means are available to determine this state of the economy in the absence of a market process. In fact, the essential problem inside the Niskanian framework concerns economic efficiency. It consists in defining suitable incentives (price mechanisms) for steering the bureaucrat toward an appropriate productive behavior to reach efficiency without an allocation of resources through the market (ibid., p. 10). This approach consists in finding the right stimulus to yield adjustment and an appropriate economic answer.

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<sup>6</sup>If Niskanen were right about this, it would become possible to market a product without the market process! This is a contradiction in terms. In fact, the commercialization of the product by a bureaucratic organization means the price is set by a planning authority and does not result from the free market process. Economic calculation has to be understood as a public allocation process with parameters (for the value of the goods produced and the costs of the production factors used) that are determined by public bodies.

This . . . theory should be applicable to the behavior of bureaus supplying services financed through any form of private organization or government. Later, an aggregative theory of the behavior of representative government is developed to describe the formulation of the demands for a bureau's output in this specific environment. (Ibid., p. 11)

For Niskanen, bureaucracy exists because of institutional failures, the so-called market failures. However, his analysis focuses on the organizational dimension and especially on the choices made by the bureaucrat and the interpersonal relationships inside the bureaucratic organization. Niskanen proposes an inside view of bureaucracy and limits his analysis to the productive dimension of bureaucracy. His purpose is to “develop a theory of ‘supply’ by bureaus, based on a model of a purposive *behavior* by the manager of a single bureau” (ibid., p. 5). Thus, Niskanen defends a *behavioral theory of bureaucracy and bureaucratic conduct*.

*b. Mises's contribution: Bureaucracy as the symptom of massive hindrances of the free market*

According to Mises, bureaucracy is the unavoidable counterpart of interventionism: of the continuous extension of the state's hindrance of private business activities and of its interference with the personal lives of citizens. Bureaucratization is a process of transforming social relationships from contractual bonds to hegemonic ones (Mises 1998, p. 198).<sup>7</sup> Bureaucratic management differs from profit-motivated management in the predominance of rules over the price system (and in the nature of those rules).<sup>8</sup> Bureaucracy means the substitution of rule-following behavior for profit-seeking behavior. Although Mises's theory deals with human behavior, it is not a behavioral theory, understood as the study of human response to stimulus. It does not focus on the incentive problem but gives much more importance to the appropriate and necessary tool to guide *human action*, using *means-ends* and *causality* concepts. As Mises correctly asserted:

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<sup>7</sup>I wish to thank Nicolai Gertchev for pointing this out. Also note “What differentiates the hegemonic bond from the contractual bond is the scope in which the choices of the individuals determine the course of events” (Mises 1998b, p. 197). See also Rothbard (1982, p. 49).

<sup>8</sup>The allocation by a price mechanism can be understood as a rule, but which is voluntarily accepted and which permits individual exchange and promotes contractual bonds. Such a rule has to be distinguished from hegemonic rules. In the rest of the paper, the terminology “rule” refers to the hegemonic type. The contractual make exchanges possible and do not constitute a means of substituting the decisions of bureaucrats for those of private individuals.

The field of the sciences of human action is the orbit of purpose and of conscious aiming at ends; it is teleological. (Mises [1957] 1985, p. 240)

Praxeology is the appropriate approach to understanding human action and the operation of the market process. The analysis of bureaucracy proposed by Mises is built upon a systematic and fine distinction between its working and the working of the market process. Indeed, according to Mises, bureaucracy can be fully understood only by means of a comparison with “the operation of the profit motive as it functions in the capitalistic market society” (Mises 1983). Consequently we can characterize Mises’s approach as a *praxeological theory of bureaucracy* which results from his particular methodology.

So what are the characteristics of bureaus? Bureaucracy is a specific management structure for the allocation of resources, a system that does *not* perform with the profit motive. The mainstream view and the Austrian view of bureaucracy agree on this point, but differ on other matters.

Unlike under a profit management system, the allocation of resources by bureaucracy is made through obedience to rules (Mises 1983, p. 50). There is no need to satisfy customers and to produce at the least cost. The system of profit and loss plays no role in the bureaucratic machinery. Indeed, bureaucratic administration of resources gives predominance to rule-following behavior. It neglects the importance of entrepreneurship and the role of prices and costs. The rules and regulations determine the product to be supplied, its characteristics, its price, and the method of production. In fact, an essential trait of bureaucratic management is *the absence of a check by economic calculation* (ibid., p. 52). For Niskanen, the existence of nonprofit organizations results from the characteristics of the goods provided, *but does not* impede economic calculation. However Mises maintains that the impossibility of controlling the profitability of economic activities is an inevitable consequence of operating without the profit motive. This is because it is not possible to put a value on production by bureaus (ibid., pp. 51–52). As Mises clearly asserts: “Bureaucratic management is management of affairs which *cannot be checked* by economic calculation” (ibid., p. 52; italics added).

It is clear that the term “economic calculation” is given radically different interpretations by Mises and Niskanen. For Mises, economic calculation rests upon the profit-and-loss mechanism and the working of an unhampered market process. The market process provides the information to guide entrepreneurial decisions. Because bureaucracy is the antithesis of the market process, it can be logically deduced that economic calculation is impossible for bureaucratic production. The

information required for economic decision is not available. For Niskanen, economic calculation is possible inside bureaucratic organizations by using external information (relative prices provided by the market before the public production, administrative prices) to determine an optimal allocation of resources. In fact, this difference of opinion regarding the possibility of economic calculation emphasizes these economists' two different conceptions of bureaucracy: behavioral and praxeological ones. The Niskanian approach maintains that price information<sup>9</sup> is enough to determine the optimal allocation of resources and to determine an incentive mechanism to attain economic efficiency by generating a suitable behavior on the part of the bureaucrat. For Mises, prices result from the market process. Entrepreneurial activity and the decisions of market participants determine the value to be put on the goods exchanged and the services provided. Consequently, the level of prices results from numerous individual decisions about allocating resources. Prices cannot be distinguished from the allocation process.

In Misesian terms, bureaucracy is the outcome of interventionism. The consequence of governmental hindrance of the market process is the absence, indeed the impossibility, of economic calculation. For Mises, bureaucracy is an instrument, the tool for executing orders and regulations. Bureaucracy is an indispensable element of the operation of the government. State hindrances cannot be carried out without bureaucratic intervention; bureaucracy is a consubstantial element of the existence of government.

Nevertheless, bureaucracy can be necessary *because of* the impossibility of checking some production plans by the tool of economic calculation. Indeed, Mises asserts that society needs a minimum of bureaucracy for government intervention. This necessary bureaucracy has to be strictly limited to the protection of property rights, physical property, and the people. This minimal state has to insure social cooperation among the members of society (Mises 1998a, p. 149; 1996b, p. 37; 1983, p. 20) and make peaceful interactions possible between the people.

There is a field, namely, the handling of the apparatus of government, in which bureaucratic methods are required by necessity.  
(Mises 1983, p. 48)

In some ways, Mises distinguishes two types of interventionism. There is a positive interventionism that makes cooperation possible

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<sup>9</sup>However, it raised the question of the quality of the information provided. Does the price clearly reflect the market situation? What about the situation in which there is no market for the publicly provided good or service?

between individuals, for instance the police and courts' enforcement of the law and property rights, and there is a negative interventionism that obstructs voluntary exchange, with disastrous consequences. The division of labor allows for economic development and the mutual gains that come from numerous exchanges in society (Rothbard 1991, p. 19). However, this wealth can be created only if there exist a system of market prices and the profit-and-loss mechanism. This economic calculation tool guides human actions. Consequently, the bureaucratic process, which is characterized by the importance (large-scale use) of rules<sup>10</sup> in the allocation of resources, interferes with the market process and the realization of individual plans. It undermines human actions needlessly. Another crucial implication of the economic calculation debate is the importance of private ownership of capital goods (Mises 1990; 1939; Pierson et al. 1939).<sup>11</sup> Mises maintains that bureaucratic interferences lead to the substitution of public decisions for private ones, with the dangers that this entails (Hayek 1993). Although Mises does not devote much time to the theory of property rights; they play a great role in the theory of bureaucracy.<sup>12</sup> The government's hindrances of the economy are made possible by substituting public decision for private affairs and by eroding property rights, and ultimately destroying them. As the basis of private property is undermined, economic calculation progressively decays. The only way of making decisions becomes, then, the command and the control of allocating resources. To sum up, bureaucracy consists in a mode of allocation of resources; the administration of resources, rests essentially upon rules and a command-control system, and resources are not privately owned<sup>13</sup> by the administrator. The negation of economic calculation under bureaucratic production reflects, in fact, the denial of private property rights and of people's freedom to decide for themselves. It represents a process of replacing this freedom with a

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<sup>10</sup>Obviously Mises does not assert that rules do not exist or do not play any function in private enterprise, but the priority is given to the price system and to the profit motive. For a presentation of the firm as a necessary structure for the calculation of profit, see Lewin (1998).

<sup>11</sup>See also Mises (1990; 1939, pp. 93–132) and Pierson, Mises, Halm, Barone, and Hayek (1939).

<sup>12</sup>Indeed, Mises's analysis deals with the nature of the results from different social arrangements of ownership, but does not defend a particular theory of the foundations of property rights.

<sup>13</sup>There is a true difference between ownership and stewardship. See Carnis (2003) for a particular application to road management.

more coercive system based on rules to and on a command-control system of decision-making (Mises 1983, p. 20).

## II. DYNAMICS OF BUREAUCRACY: ORGANIZATIONAL OR INSTITUTIONAL EXPLANATION?

For Niskanen, the dynamics of bureaucracy are explained partly by the particular structure of bureaucratic production. Informational asymmetry gives a strong advantage to the bureaucrat over the sponsor in bargaining for a higher budget than is required to provide the output. Self-serving behavior of the bureaucrat and competition among the bureaus for obtaining and keeping budgets and grants are the main components of this dynamic. Mises's theory radically differs from this. Mises argues for an *institutional version* of the dynamics of bureaucracy, whereas Niskanen focuses on the *organizational* dimension. According to Mises, the impossibility of economic calculation under an interventionist regime results in disappointment and inefficiency, which feed further interventionism and a higher degree of bureaucratization. This self-sustained process is reinforced by agents grasping new opportunities brought about by the governmental hindrances themselves.

### *a. The dynamics of bureaucracy as an organizational effect*

According to Niskanen, the dynamics of bureaucracy can be understood by investigating the organization of the production structure. A combination of internal factors explains the process of the bureau's expansion. The organizational explanation of the bureau's expansion rests upon a specific relationship between the sponsor and the bureau which is characterized by asymmetry. The incentives the bureau and the sponsor have to face conjointly reinforce the tendency for the budget to increase. This is the private-interest-seeking behavior argument.

The Niskanian analysis conceives the bureaucratic relationship as a bilateral monopolistic situation between a sponsor (which provides the budget) and a bureau (which provides the production). There is a bargain between these agents concerning the output and the budget (Niskanen 1994, p. 24). However, the bureau holds an advantageous bargaining position because it has a better understanding of its own workings and its costs of production (*ibid.*, p. 29). This situation is reinforced by some difficulties that the sponsor has to face: he has no alternative for the provision of these goods and services and is unwilling to forgo the production (*ibid.*, p. 25). This situation of *asymmetrical information* allows

the bureau to extract a higher budget than it would need in order to provide a given quantity of goods or services.

There is also informational asymmetry in the relationship between the politician and the citizen. As Niskanen points out, the conditions of bureaucratic production are quite specific. On the market, the customers directly reveal their preferences, their needs, and the amount of money they are ready to forgo in exchange for a specific good. The exchange stipulates the quantity and the characteristics of goods or services. In the bureaucratic process, however, the demonstration of needs and preferences is indirect. The citizens transmit their preferences to the politicians and the sponsors, who negotiate and bargain with particular bureaus for the provision of goods and services. This two-step process reinforces the bureaus' ability to extract a higher budget. There is also the possibility that informal coalitions may be formed between the sponsor and the bureau to serve their own interest to the detriment of that of the population (Fiorina and Noll 1978, pp. 256–60).

The informational asymmetry is only a part of the reason why the budgets of bureaucracies expand. An additional hypothesis concerning the *behavior of bureaucrats* has to be introduced in order to provide a full understanding of the process. In the Niskanian framework, the bureaucrat is not considered as a passive and unselfish person. Like other people, he seeks to maximize his own utility (Niskanen 1994, p. 36). The bureaucrat's action is not motivated merely by the general welfare or the interest of the state; he strives for personal advantages. Because he is unable to correctly understand the meaning of the public interest and because he has neither the omniscience nor the sovereignty to be able to accurately define such a concept, he can only give his personal interpretation of what the public interest is. Thus, there is a true conflict between serving the public interest and the satisfying his personal objectives. Moreover, serving the public interest appears as an impossible goal because there are as many definitions of the public interest as there are bureaucrats (*ibid.*, p. 39). This opens the door to all kinds of interpretations and facilitates actions to satisfy personal interests. The latter can be satisfied through a higher budget and a discretionary budget, which can take the form of prerequisites of the office in order to ease the working of the bureau (Migué and Bélanger 1974, pp. 24–28).<sup>14</sup> With a lax

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<sup>14</sup>Initially, Niskanen defended the hypothesis that a bureaucrat maximizes his budget. Criticism by Migué and Bélanger strongly influenced the evolution of Niskanen's thought on this point. "My prior assumption that bureaucrats act to maximize their budgets, I suggest, should now be dropped entirely in favor of an assumption that they act to maximize their discretionary budget" (Niskanen 1991, p. 28). For a critical

budget, it is possible to hire more bureaucrats, to create opportunities for more manager positions, and to allocate some resources for particular tasks. A bigger bureau gives more prestige to its manager-director, and more power for managers over many subordinates.

In this manner, Niskanen explains the overexpansion of the bureau and the increase of its budget by the rational efforts of the bureaucrats to maximize their personal utility and to obtain a discretionary budget. Another argument is advanced to explain the expansion of bureaucracy: *the survival argument* (Niskanen 1994, p. 39). The bureaucrat's actions have to comply with different constraints. Thus, subordinates have some influence on effective functioning of the bureau and their careers depend in part on suitable decisions made by the manager. The manager, for his part, needs the cooperation of his subordinates to protect the budget of his organization and to enable him to win promotion. In fact, the bureau is a collective organization whose good performance depends on the execution of orders and directives by the subordinates, and on cooperation between the different bureaucrats (manager and subordinates). Thus, the bureau needs a minimum of efficiency to justify and to ask for a higher budget from the supervising agency, and the supplementary budget that allows the manager to reach a part of his objectives. Consequently, there is a strong convergence between the interests of bureaucrats on the objective of promoting an increase of the budget.

The political process also explains the tendency of bureaus to expand. Review officers have their own objectives and their particular interests to satisfy. They need the bureaus to supply projects and make proposals for public spending (*ibid.*, p. 40), thus justifying the review officers' own budget and position. In brief, there are few incentives inside bureaucratic organizations to promote efficient productive methods and to control the size of government, because of the tendency to increase the budget in order to satisfy personal interests and the inclination of the sponsor to increase the funding of projects.

The asymmetry of information, the bargaining between the sponsor and the bureaucrat, the indirect transmission of consumers' preferences, the private-interest-seeking behavior of bureaucrats and politicians, and the survival behavior of bureaus are the essential factors sustaining the tendency of bureaus to expand, according to the Niskanian account.

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review of this hypothesis, see the collective work edited by Blais and Dion (1991). Other authors go further by calling into question the hypothesis that bureaucrats act to increase the size of the bureau (Tullock 2002, p. 58; Shun-Yuen Chan 1979).

Niskanen also shows the importance of the human dimension for understanding public production. Public intervention cannot be presented anymore as a mechanical application of means to attain specific ends. Niskanen also stresses the importance of the various hidden interactions behind the process of public production and the implications of the political framework. The dynamics of the Niskanian bureaucracy has its origins in the *behavioral* dimension of this peculiar organization.

*b. An institutional explanation of the dynamics of bureaucracy*

For Mises, the process of bureaucratization results from three main different factors. The first factor is the impossibility of applying economic calculation and of correctly allocating resources. Mises also identifies political and social reasons for the growth of bureaucracy: respectively, the intrusion of the state in the business and private affairs of citizens, and the impact of bureaucracy on innovation and the vitality of society. Mises's explanation implies that the dynamics of bureaucracy bring about the decline, and ultimately the destruction, of the free market order.

It has already been pointed out that bureaucratic allocation of resources relies upon rules and a command-and-control scheme of decision, which results in the inability to verify that resources are correctly allocated among the different alternative plans of production (Mises 1983, p. 25). The bureaucrat is unable to correct errors; bureaucratic management produces an important cycle of error in the economy (Hülsmann 1998), with progressive extension of government hindrances, which will ultimately require brutal corrections. As Mises asserts: "In this as in many other instances the bureaucrats see in the failure of their preceding measures a proof that further inroads into the market system are necessary" (Mises 1983, p. 35). Bureaucratic management wastes resources and generates losses and frustration among the population because of its deficiencies in the allocation of resources. The governmental answer to frustration and to its previous unsuccessful intervention is further interference in the economic sectors concerned, and also new kinds of interference that impede the working of other markets (Mises 1996a, p. 8).<sup>15</sup>

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<sup>15</sup> If the government would like production to continue, it must force the producers to continue, and it must also control the prices of raw materials, semifinished products, and wages. But such controls must not be limited to a few industries which government meant to control because their products are believed to be especially important. The controls must encompass all branches of production, the prices of all goods and all wages, and the economic actions

Mises provided a sound analysis of the different modalities of interventionism and its consequences (Mises 1998a). He also showed the implications of the effects of interaction and their spread through the economywide credit expansion and the business cycle (Mises 1998a, p. 44).

The dynamics of bureaucracy result in the extension of governmental economic hindrances through the creation of new public bodies (public administration, bureaus, and public firms) (Mises 1983, p. 65), and also the propagation of new interferences in the management of for-profit firms. Restricting profits, influencing the management of personnel (*ibid.*, p. 75 ff.), determining the price of goods or of factors of production, and deciding how much shall be produced are forms of this larger scope of government hindrances. Mises clearly showed that the criterion of profit is enough to organize the firm from the bottom to top. Consequently, bureaucracy represents an unnecessary evil for the management of private enterprises.

The bureaucratization process propagates itself by progressively modifying individual preferences for entrepreneurship. First, bureaucracy impedes the working of the market process. Indeed, bureaucracy reduces the incentives for entrepreneurs to make profits and to reduce the costs of production. Second, entrepreneurial activity becomes relatively too costly compared to the bureaucrat's requirements. Entrepreneurs have to innovate, to search for new methods of production, and to try to satisfy the consumers in order to generate higher revenues and profits. They have to face uncertainty. Bureaucrats only have to follow orders and respect defined rules. Third, government hindrances also bring about, for some firm owners, a transformation of their objective. This does not consist anymore in satisfying the consumers in order to obtain revenues and make profits, but in pleasing the politicians in order to obtain privileges and protection for their economic activity or insure outlets for their production. Bureaucracy acts as an annihilator of innovation and entrepreneurship (*ibid.*, p. 73).

The evolution of preferences also concerns the political and social fields. With massive governmental hindrances, *statolatry* becomes the popular ideology. Individualism is perceived as an evil and an expression

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of all entrepreneurs, capitalists, landowners, and workers. If any industry should remain free, capital or labor will move to it and thus frustrate the purpose of government's earlier intervention. Surely, government would like an ample supply of those products it deemed so important and therefore sought to regulate. It never intended that they should now be neglected on account of the intervention. (Mises 1996a, p. 8)

of selfishness. The state is seen as the solution, the means to solve conflicts between individuals and to avoid the “materialization of morality.” In such a system, the consumers lose their power of decision by which they could determine their needs and the means to satisfy them. Henceforth the state carries out the central function of deciding for people, and the officeholder comes to dominate practical decisions. Thus, consumers are deprived progressively of their sovereignty. This slow transformation of the political and social order makes it easier to reinforce the process of bureaucratization. The institutional explanation of the dynamics of bureaucracy seems to be characterized by an *auto-poietic* dimension. Bureaucratization is self-sustained; interventionism calls for further interventionism.

This situation is also reinforced by the political position of the bureaucrat as a voter. He benefits from a privileged position. The bureaucrat is simultaneously a consumer of public production and an employee in the process of bureaucratic production. His interest is to increase his own advantages and to raise the budget of his organization (Mises 1983, p. 87). The greater the proportion of public officeholders in a population, the greater will be their influence and their power of decision through the political process and elections. The particular situation of bureaucrats gives them the opportunity to increase their privileges, their payroll, and the size of their bureaus.

Not only is the bureaucratization process made easier by the central position of the bureaucrat, but there is also a simultaneous “bureaucratization of the mind.” Government controls education through its administration of the university and by defining the contents of school programs. Moreover a certain intelligentsia, whose role consists in justifying the intervention of the state and the extension of this interference, denigrates the free market economy (Hoppe 1995; Mises 1983, pp. 90ff.).

Mises provides an institutional explanation of the bureaucratization process. The absence of economic calculation leads inevitably to disappointment and frustration. This in turn calls for more intervention and more bureaucratic hindrances. Although the government appears to be the solution, it is the very root of the problem. The massive intrusions of government in private business and private affairs modify people’s social and political preferences: entrepreneurship is not praised anymore, public decision is substituted for the freedom to decide for oneself. The dynamics of bureaucracy are reinforced by the actions of public officials and politicians eager to grasp new interventionist opportunities. Thus bureaucratization appears to be a self-sustained process. However, this process is not endless. The ultimate stage is the destruction of the market order and of society, resulting in chaos (Mises

1983, p. 62). Bureaucracy drives inexorably toward “rigidity,” ossification, “petrification and death” of society (Mises 1983, p. 111).

### III. HOW TO ESCAPE THE DOWNSIDES OF BUREAUCRACY AND TO LIMIT THE BUREAUCRATIZATION PROCESS

The differences between the means proposed by our two authors for solving the problem of bureaucracy are strongly influenced by their particular theoretical framework. Niskanen’s goals are to promote competition and elaborate mechanisms which could provide information to the sponsor. He proposes to promote competition among bureaucracies and to control the asymmetry of information in order to approximate the ideal of the perfect competitive situation. The objective is to provide adequate information to make possible an efficient allocation of resources through economic calculation.

The conclusions drawn by Mises are more radical. Because bureaucracy is the symptom of a higher evil for society, that is, interventionism, the solution is to promote capitalism by economic education and to reduce governmental hindrance of the private economy. Economic education must reverse the trend of preferences for socialism, and interventionism must be restricted in order to permit better functioning of the market process by giving a greater place to economic calculation.

#### *a. The Niskanian solutions: competition, incentives, and the rules of decision*

Niskanen assumes that it is possible to define appropriate organizational conditions to make a bureau produce efficiently. Niskanen identifies some necessary incentives to cause the bureaucrat’s behavior to evolve toward efficient production.

First, the introduction of competition is expected to generate incentives for enhancing productive efficiency. The existence of many bureaus able to produce the same good or service also enables the sponsor to hold more information on the costs of production and to compare the different units of production. Competition means that bureaucrats have less autonomy to satisfy their own utility and to extract resources (Mises 1983, p. 199). However, Niskanen stresses that such a reform could promote only a tendency toward a higher productive efficiency. In some ways, Niskanen assumes that it is possible to replicate the working of the market (*ibid.*, p. 195). Competition among bureaus is expected to reduce their monopoly power by revealing information about their costs of production and by providing a known alternative to make selection easier for the sponsor.

Second, change of incentives inside the bureaucracy itself is a possibility for solving the problems of bureaucratic production. Niskanen proposes

introducing different special rewards for the bureaucrat or the bureau, with the aim of reducing the total costs of production. The goal would no longer be to maximize the total budget but to maximize the difference between the budget and the costs of production. Niskanen's objective is to *reintroduce the mechanism of profit* inside the working of the bureau. Niskanen is nonetheless aware that such a reform of incentives can produce perverse effects (insufficient production in a monopolistic situation, difficulty for the sponsor in determining and measuring the output) or generate undesirable behavioral feedback from bureaucrats (less motivation, strategic behaviors, social acceptance of such mechanisms). Niskanen also deals with the importance of analyzing the productive process and the stakes on the control of information. However, the production of information can be manipulated, or corrupted by the conditions under which it is produced. That explains why Niskanen is less inclined to develop such a solution. The major root of the bureaucratic problem results from the structure of production and its system of incentives. It does not come from a lack of knowledge.<sup>16</sup> The possession of the existing information, spread differently through the public production process appears to Niskanen to be the key to reforming bureaucracy successfully.

Third, some market alternatives are also available. Niskanen proposes transferring some bureaucratic production to the private sector, particularly for goods that can be marketed. To avoid insufficient production by the private sector, he proposes that the government pay or subsidize private production. In short, Niskanen argues in favor of contracting out some public services.

Fourth, Niskanen proposes political alternatives, which would reduce the importance of the demand group, for the goods, and their influence on

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<sup>16</sup>Again we should note here a characteristic of the mainstream approach. Knowledge is not a true problem. Indeed the optimal function of production is supposedly known. The economic problem is only a problem of incentives.

In any case, better analysis and information are not a general solution to the problems of bureaucracy. The superior performance of market institutions is not due to their use of better or more analysis. In fact, most of the formal, "sophisticated" resource allocation analysis in this nation now serves the bureaucracy. The primary differences in the performance of different organizations are due, rather, to differences in their structure and the incentives of managers. (Niskanen 1994, p. 212).

Mises shares on this point a totally different view. Indeed, the economic calculation argument shows clearly the importance of information for the allocation of resources to the more urgent needs and the necessity of correcting errors (Mises 1990). See also Sautet (2000); Ikeda (1997); Kirzner (1997, 1992).

those making decisions. Niskanen wishes: to modify the requirements of officials that are nominated to become bureaucrats within an organization; to require representatives to specialists; to avoid situations of asymmetrical information; to develop a watchdog committee; and to modify the majority rule (requiring a two-thirds majority to approve the budget and all public services) in order to increase the control of demand.

The bureaucratic production structure results in inefficiency and oversupply. Economic calculation must be used to assess the efficiency of various types of bureaus. Consequently, the different proposed solutions are aimed at restoring the necessary incentives for economic efficiency.

*b. An impossible trend to reverse?*

What are the solutions proposed by Mises to avoid bureaucracy? The last chapter of *Bureaucracy* expresses a kind of pessimism by asserting that socialism would be unavoidable.<sup>17</sup> Mises describes a collective powerlessness to fight the expansion of bureaucracy and interventionism, which appears as a collective choice (Mises 1983, p. 119).

Mises denounces demagogic thinking and partial analysis, which promote interventionism as the solution to all problems. His solution would rely upon personal economic education. But the education provided by government belongs to the general arsenal of official propaganda (Mises 1972). Thus, this solution seems to be a very weak one with which to face the considerable means of propaganda deployed by government. Moreover, the process of bureaucratization identified by Mises leads to the transformation of individual preferences<sup>18</sup> toward more interventionism. The members of society lose their common sense. Only a change in ideology could reverse the process of bureaucratization. (Mises 1991, p. 68). The first solution has its origin in individual choice and values. The dynamics of bureaucracy could be stopped if individuals chose not to consider government as the ultimate recourse.

Nevertheless, Mises also presents an optimistic position. This concerns the self-defeating characteristic of interventionism (Mises 1985, p. 129). The self-sustained characteristics of the dynamics of bureaucracy have already been discussed. The ultimate stage of bureaucratization would be socialism, but such a system of production is unstable and not sustainable. At its ultimate stage, interventionism destroys itself. Such a self-defeating process would also provide people with knowledge by

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<sup>17</sup>We have to place this analysis in the historical context of nazi Germany and the expansion of communism with the Stalinist Soviet Union.

<sup>18</sup>For a theoretical approach of the evolution of preferences to explain the expansion of interventionism, see Ikeda (1997).

revealing what is the efficient and productive system and which systems are associated with destruction, frustration, and poverty. There would be a trial-and-error process of collective learning about the appropriate social order. The restoration of the free market order is necessary to make coordination possible among the plans of individuals and to secure prosperity.

In fact, the most radical proposition for fighting bureaucracy is to eradicate all forms of interventionism. According to Mises, there is no middle way for dealing with the economic problem (Mises 1991). Two alternatives are possible: capitalism or socialism. Because socialism is condemned to failure, capitalism is the only viable solution, which will succeed in imposing itself (Mises 1985, p. 128).<sup>19</sup> This will entail the privatization of some present bureaus, the disappearance of others, and the emergence of a true free market. Because the dynamics of bureaucracy are based on the impossibility of using economic calculation, the solution consists in restoring and developing its use.

Consequently, there are two different paths to an understanding of bureaucracy. On the one hand, the analysis proposed by Mises represents a strict condemnation of the solutions advanced by Niskanen. It is impossible, Mises says, to mimic the workings of the market. Bureaucratic management is characterized by the impossibility of applying economic calculation and by the absence of the profit motive. Without these things the performance of a market economy is unattainable. As Mises clearly stated: “the reasoning of the advocates of this middle solution is entirely fallacious” (Mises 1985, p. 128). On the other hand, Niskanen is aware of these divergences with previous theories of bureaucracy. However, his approach in terms of productive efficiency leads him to consider it possible to transform the practices of bureaucracy by injecting methods borrowed from the market process.

#### IV. CONCLUSION

Both economic approaches to bureaucracy analyzed here share the view that bureaus do not perform efficiently. However, these analyses differ radically on the reasons of the existence of bureaucracy, the factors explaining its dynamics, and the means of avoiding its disadvantages.

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<sup>19</sup>For a less radical approach, which tries to explain the existence of mixed economies, see Ikeda (1997). The evolution of preferences and the increasing opportunity cost associated with more and more interventionism contribute to a complex system of interactions which makes it possible to imagine the prevalence of a of mixed economy in spite of its unstable character (Ikeda 1997, pp. 215 and ff.).

According to Niskanen, bureaucracy exists because of market failures. However, the particular production conditions of bureaucracy (a monopolistic situation, a discretionary budget, self-serving behaviors of bureaucrats, and asymmetrical information) lead to oversupply and inefficiency. Economic calculation makes it possible to identify these inefficiencies. Niskanen defends a *behavioral* theory of bureaucracy, because bureaucracy's defects come from inappropriate behaviors. He also offers an organizational explanation of the dynamics of bureaucracy. To overcome these perverse effects, government has to select the correct incentives to induce efficiency and to reorganize the conditions of production.

For Mises, bureaucracy is the unavoidable consequence of interventionism. It implies hindrances, inefficiency, and disturbances in the working of the free market. It erodes the foundations of the free market order by violating property rights and by impeding adjustments by the market. One main effect of bureaucracy is the destruction of the role of economic calculation. Mises proposes a *praxeological* theory of bureaucracy, because bureaucracy's effects have to be assessed through its consequences for human actions and their coordination. He describes the dynamics of bureaucracy as a self-sustained process: bureaucracy calls for more bureaucracy. The solution is the restoration of economic calculation and the elimination of interventionism.

Thus, Mises and Niskanen disagree completely on the reasons for the existence of bureaucracy. There are also radical divergences concerning the consequences and the solutions that could be implemented. Niskanen focuses on the organizational dimension. According to Mises, bureaucracy deals with a command and control mode of allocating resources. In fact, these divergences of opinion reflect the opposition between two main schools of classical liberalism, the Public Choice School and the Austrian School, and finally between two theories of liberty, and of what a free market means (Salin 2000).

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