

## NEW PERSPECTIVES ON THE ECONOMIC APPROACH TO BUREAUCRACY

LAURENT A. H. CARNIS

*ABSTRACT:* Bureaucracy may denote either a means of management, or a particular kind of organization. Characteristics of such organizations include the existence of a discretionary budget, a tendency to expand their resources continuously and progressively, the absence of profit-seeking behavior, and competition for political position inside the organization. This paper argues that if we are to understand the functioning of bureaus and determine their consequences for the allocation of resources, two main characteristics of bureaucratic organizations will require more attention than they have received. These are the impossibility of economic calculation and the absence of clearly defined property rights to public assets and resources. This paper points out that management of public resources is most accurately characterized as stewardship, not ownership, and develops new perspectives on the economic theory of bureaucracy.

*KEYWORDS:* bureaucracy, economic calculation, property rights

*JEL CLASSIFICATION:* D23, D73, P16

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Laurent Carnis (laurent.carnis@inrets.fr) is a Researcher at INRETS—DEST (French National Institute for Transport and Safety Research—Department of Transport Economics and Sociology) Descartes 2, 2 Rue de la Butte Verte 93166 Noisy-le-Grand, France.

This paper was presented during the 2008 Austrian Scholars Conference in Auburn, Alabama.

## INTRODUCTION

Today's economic systems are characterized by omnipresent public-sector intervention, and we all have to come to terms with various forms of governmental intrusion into most aspects of our daily lives: direct intervention regarding prices and revenue, direct hindrances of the market in terms of the production and distribution of goods and services, and the creation of obligations and prohibitions that must be abided by (Ogus, 1996). These governmental interventions require the existence of an administrative support organization to implement them.

Current economic theory includes a broad range of hypotheses which reflect various theoretical approaches to the state and to the interpretation of state intervention. However, this consideration spills over into issues of political philosophy which, though they do influence our comprehension of the "administrative phenomenon," will not be relevant to this study.

The aim of this article is to contribute to the theoretical work in progress and to open up new avenues toward understanding bureaucracy and its organization. The article highlights two basic characteristics: the absence of clearly established property rights to resources and production, and the impossibility of basing the allocation of resources on economic calculation.

The first part of the article sets out to define the contributions and limitations of prior theories and to suggest an integrative theory which, while sharing certain interpretative emphases with its predecessors, is markedly different from them. This theory is "integrative" in that it makes no distinction between the organization as such and its internal functional mechanisms.

The second section focuses on the consequences of administrative management: injudicious allocation of resources, the spread of economic distortion to the economic system as a whole, and the destruction of entrepreneurial skills.

The final section considers the functional mechanisms of bureaucratic organization—mechanisms whose distinctive character make the workings of this kind of organization difficult to keep track of.

## TOWARDS A NEW THEORY OF BUREAUCRACY

### CONTRIBUTIONS AND LIMITATIONS OF PRIOR THEORIES

Economists have made a substantial contribution to the analysis and understanding of bureaucratic organizational systems by creating soundly based theoretical models (Tullock, 1965; Mises, 1983 [1969, 1944]; Breton and Wintrobe, 1986 [1982]; Downs, 1994 [1966]; Niskanen, 1994 [1971]). This theorization has, firstly, made it possible to highlight the specific characteristics of bureaucracies in comparison to the functioning of private companies (Grefe, 1981); and secondly has built an independent interpretation and a specific economic approach to bureaucracy that rivals in value the analyses from the fields of sociology and political science (Weber, 1952; Blau, 1955; Lipsky, 1980; Crozier, 1971 [1963]).

Most economic theories of bureaucracy are mainly concerned with the internal mechanisms and decisional characteristics of the organizations in question. In different ways, these studies come to the conclusion that there exist both public and private bureaucracies. Thus Niskanen's definition of bureaucracy—non-profit-seeking and not sales-financed—does not allow for a formal distinction between a charitable organization and the Department of Justice (Niskanen, 1994 [1971], ch. 2).<sup>1</sup> The notion of power that Tullock brings into his analysis does not allow for a distinction between a big company and a state administrative body. Wintrobe and Breton's concept of hierarchy is equally applicable to private firms and public organizations (Breton and Wintrobe, 1986 [1982], p. 13). Likewise, Mises's theory of bureaucracy, based on the absence of economic calculation, allows for no distinction between family, clan, and public-sector organization (Mises, 1983 [1969, 1944], p. 50).

And so these theories tend to generate a degree of conceptual confusion, since the private/public dichotomy and the specific characteristics of the two sectors are discounted in favor of organizational and decisional modalities. These theories conclude that there exist both private and public bureaucracies. But is the presence of a bureaucratic process sufficient grounds for describing

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<sup>1</sup> Niskanen's theory sees profit in purely financial terms, and neglects its psychological aspects.

private organizations as bureaucracies? For this would mean, in certain respects, putting a private company in the same category as a government department. And even though these various proposed definitions of bureaucracy do not permit a formal distinction between certain private organizations and public ones (Sauvy, 1956), the analyses by the different authors unequivocally reveal what their real subject is: government organizations. The consequence is that the different theories ultimately separate the functioning process from the form of organization under study.

### TOWARDS AN INTEGRATIVE THEORY

The approach to bureaucracy put forward here is more integrative than earlier approaches in that it does not separate functional decision-making processes from organizational form. In this respect, the container cannot be distinguished from the contents: the two form a whole. In short, bureaucracy is defined by special procedures and rules of functioning, which turn out to be inherent in specific organizational structures. Bureaucracy is characterized by *an organizational form whose non-legitimately-owned<sup>2</sup> resources are allocated by one or more administrators (bureaucrats) according to a more or less elaborate system of rules whose origin and implementation are governed by command and control relationships.*

This definition stresses two characteristics vital to the description of a bureaucratic organization. Firstly, the allocation of resources does not depend on any economic calculation, such calculation being absent or impossible. Secondly, there exists no real definition of rights of ownership of the resources used by these organizations and the resultant production.

To my knowledge, Mises's studies are the first to have emphasized the absence of economic calculation in the allocation of resources within bureaucracies (Mises, 1983 [1969, 1944]). As bureaucracy is not concerned with maximizing profit, it is not obliged, in allocating resources, to take account of the system of relative prices.

Bureaucratic management is management of affairs which cannot be checked by economic calculation. (Ibid., p. 52) ... A bureau is

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<sup>2</sup> Here I follow Rothbard's theory of justice (Rothbard, 1982).

not a profit-seeking enterprise; it cannot make use of any economic calculation; it has to solve problems which are unknown to business management. (Ibid., p. 53)

Moreover, it is not uncommon for renunciation of maximum profit to go hand in hand with a lack of sales of output.<sup>3</sup> In certain situations, the absence of pricing of production, and thus of any commercial transaction, represents the natural extension of a renunciation that consists in eliminating all financial references from the production and sales cycle. As a result, the bureaucracy lacks the necessary instruments for determining the viability of its production and is unable to correct the production dysfunctions that may arise. It does not, and cannot, use economic calculation to determine either the market value of its production or the efficiency of its productive structure. And so allocation of resources must depend on another factor: rules laid down by a higher authority, such as a dictator or parliament.

Bureaucratic management is management bound to comply with detailed rules and regulations fixed by the authority of a superior body. The task of the bureaucrat is to perform what these rules and regulations order him to do. (Mises, 1983 [1969, 1944], p. 50)

True, private firms can also establish rules and implement them in their functioning. These can be *technical rules* (founded on chemical or mechanical know-how, for example), *accountancy or routine-based rules*, or *agreements* that actively influence company organization and resource allocation (Lewin, 1998, p. 511). Even so, these rules can be adapted if the structure of relative prices and revenue so requires; i.e., they have been and still are subject to ratification by market processes. Not only do they undergo the test of the market, they may also result from the processes of a market that has selected and defined them as meta-rules necessary to its functioning, such as profit-seeking and the definition and observation of property rights in terms of contracts, property, areas of responsibility, etc. Mises accurately identified economic

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<sup>3</sup> Certain bureaucracies can demand a financial contribution in return for benefiting from their production. Even if this involves a sale, the goal is not to make a profit, but to discriminate between potential beneficiaries or reduce demand for a production the consumer gets “for free.”

calculation as a means of organizing the private company as a whole and determining its size and organizational modalities (Mises, 1983 [1969, 1944], p. 70).

Consequently, the existence of rules within companies does not necessarily signal the presence of a bureaucratic structure or of procedures of bureaucratization, if the rules have been subjected to ratification by a market that has made them a precondition of its functioning and can redefine them at any time. Such rules can thus be clearly distinguished from those that are imposed by an authority in a command and control relationship.

The second crucial characteristic of bureaucracy is the absence of a clear definition of property rights to the resources used and the resultant production. The financing of the bureaucratic organization does not come from sales, and is therefore not the outcome of voluntary, mutually advantageous exchanges with consumers.

One would not think it difficult for scholars and laymen alike to grasp the fact that government is not like the Rotarians or the Elks; that it differs profoundly from all other organs and institutions in society; namely, that it lives and acquires its revenues by coercion and not by voluntary payment. (Rothbard, 1997 [1961], p. 172)

To a certain extent, the bureaucratic production process implies forced collectivization of its financing through an appropriation of resources based on compulsion.<sup>4</sup> Having become the keepers of resources, bureaucrats take control of their use and can appropriate part of the resultant revenue (Niskanen, 1994 [1971], p. 36).<sup>5</sup> The part of the revenue that is appropriated does not always take financial form and is not counted as part of the resources remaining after production costs have been covered (the profit). Consequently this appropriation of revenue does not always emerge as

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<sup>4</sup> Buchanan and Tullock have come up with a justification for collectivization of resources that does not refer to the notion of compulsion (Buchanan and Tullock, 1997 [1962], ch. 5). In their view, a minimum of collectivization of resources is needed for the taking of a collective decision that would reduce the cost of external effects. Voluntary and free of compulsion, such collectivization of resources takes different forms: private and mutually voluntary, or governmental and collective.

<sup>5</sup> In his theory of bureaucracy, Niskanen uses Migué and Bélanger's ideas on discretionary budget.

an official procedure: the citizen or taxpayer<sup>6</sup> is not always aware of it, having no exact, reliable information on the subject. Nor does this appropriation of resources require the existence of a surplus of resources in relation to production costs, for it takes place during, and not after, the production process. Thus, the amount of revenue that can be appropriated does not depend on the productive effort, although the organization's budgetary constraints do set limits to this revenue. This revenue appropriated by bureaucrats constitutes a real production cost.

The absence of property rights to the resources used by a bureau does not mean that there was never any legitimate owner. If we take Rothbard's position on property rights and his analysis of the state, then public-sector production means dispossessing the original, legitimate owners of the resource to the advantage of the bureaucrats (Rothbard, 1993 [1962], p. 828). The process of public production, then, dispossesses the legitimate owner without specifying new owners. The bureaucrat becomes keeper, manager, and protector without being the owner. Thus the public production process can be thought of as a systematic, widespread business of expropriation and of "dis-appropriation"—a process of deleting property rights. Were the bureaucrat to become the new owner, it would be in his interest to privatize all revenue associated with use of the resource so as to satisfy his own wishes. This would doubtless lead to modification of the nature and technique of production. The resources would no longer be public, but would simply have been transferred to one or more new owners. The unfortunate thing about public production is that the new keepers of the resource do not own it and have no incentive to make effective use of it since they cannot appropriate the residual revenue. Thus, bureaucratic production leads to the breakdown of the bond between the resource and its legitimate owner, without creating a new property bond. The resource becomes everybody's property while being nobody's *exclusive* property. What is involved is a kind of forced pooling of resources (Carnis, 2003, pp. 96–97).

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<sup>6</sup> They may tolerate the practice, being aware of it without having any real information on its extent. This state of affairs can generate fantasies about benefits that may, in fact, be nonexistent.

The breakdown of the property bond concerns not only the resources used, but also production itself. There is no appropriation in the strict sense, but rather a practice of authoritarian allocation of resources. Admittedly, certain categories of beneficiaries can be identified, but the criteria used reflect an arbitrary, shifting process of designation. The beneficiary obtains the resource because the bureaucracy has so decided, and not because there has been a real act of appropriation.

Furthermore, the requests for goods and services made to the bureaucracies by the higher authorities remain fairly imprecise. Since consumer preferences cannot be revealed by the dynamics of commerce, production characteristics are determined, approximately, by the bureaucratic authority. The supposed aims of a bureaucratic organization can be so vague that production is determined according to a completely subjective interpretation by the bureaucrat himself; in addition, the organizational rationale can also lead to the orientation of production towards goals which are those of the organization, and this to the detriment of users (Lipsky, 1980, pp. 40–48). The lack of sophisticated information systems for orienting production of goods and services leads consumers to adapt to a relatively uniform, and thus unsuitable, “forced” or “compulsory” supply. This situation can also lead to clashes between the uses made by different consumers, without there being a relevant, objective criterion for coordinating uses and deciding which demands should be given priority. In some instances, bureaucratic production of certain goods and services is directly used or consumed by the users themselves. In such cases, there is privatization of consumption-associated revenue. Even so, this does not imply a real appropriation of the merchandise that would encourage reasoned use and conservation of the resource. Provision of a public park, for example, allows users of the park to benefit from revenue accruing from its use, but without any incentive to behave in accord with its future preservation. The ongoing deterioration of park equipment results in fact from the impossibility of privatizing the future revenue associated with its use, for bureaucratic production does not allow for exclusive ownership rights,<sup>7</sup> only for usage rights (Block, 1993, pp. 220–27).

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<sup>7</sup> The only cases in which bureaucratic production establishes an ownership bond

## THE ECONOMIC CONSEQUENCES OF BUREAUCRACY

Bureaucracy is a distinctive form of organization whose consequences need to be analyzed. This paper will restrict itself to identifying the economic consequences of bureaucracy. In addition to the economic consequences, Mises's work, which takes a societal approach, clearly points out the social, political and psychological implications of bureaucratization (Mises, 1983 [1969, 1944]). Most economic theories of bureaucracy succeed to a relatively satisfactory extent in identifying the characteristics and functioning mechanisms of these organizations, but without always being able to pin down any clear consequences (Tullock, 1965; Downs 1994 [1966]). Niskanen's approach, which throws light on the consequences of bureaucratic functioning by focusing on internal organization—the structure of the relations between sponsor and producer, and on the behavior of the bureaucrat—has given rise to considerable debate (Niskanen, 1994 [1971], p. 36), (Blais and Dion, 1991).

In the light of the definition of bureaucracy proposed here, we can distinguish three main economic consequences (a list not intended to be limitative): inefficient allocation of resources, destabilization of markets, and the destruction of the entrepreneurial function.

### INEFFICIENT ALLOCATION OF RESOURCES

The first consequence of bureaucracy, injudicious allocation of resources, results from the impossibility of economic calculation and from the lack of clearly defined ownership rights. The absence of market prices within the bureaucratic structure makes it impossible to evaluate production or to determine the

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are those in which merchandise, a service, or revenue is granted to a specific person as his own property: here the bureaucratic structure no longer applies common usage rights to "public property," but transfers the ownership rights of individuals to other individuals ("onward transfer"). The erosion of ownership rights then takes another form, since the redistribution of rights has necessitated prior confiscation: the issue is no longer usage rights, but fiat rights or drawing rights on existing properties. In other words, it is the fact that tenure of property is not definitive, but subject to expropriation.

economic viability of the productive structure (Mises, 1983 [1969, 1944], p. 52). This in turn makes it impossible to correctly allocate resources within an organization, an industry, or an economic sector. The system of relative prices, which is a vector for information and a guide for the entrepreneur in a free-market context, cannot be used in the interests of rational allocation of resources within a bureaucracy.<sup>8</sup>

The impossibility of remunerating at their market value the production factors utilized in the bureaucratic productive process also leads to their overuse and inefficient use. There exists no accurate means of settling on the economically effective productive structure, since the information necessary for doing so does not exist. Furthermore, because the resource is used without reference to the cost of obtaining it, a persistent idea that it is, in a way, free and relatively plentiful causes bureaucrats to fail to use it attentively (De Alessi, 1969, pp. 18–19). With respect to the labor factor, this explains, at least in part, why the directors of bureaucracies are always keen to recruit more staff—whose cost does not seem to them a vital consideration—in spite of the fact that the lack of incentives to efficiency means that the aim of such hiring is neither increased production nor improved performance. What is more, this situation is demotivating for the personnel because performance cannot be accurately assessed and, as a result, is not appropriately rewarded. Parkinson’s Law applies perfectly here:

The fact is that number of the officials and the quantity of the work are not related to each other at all. The rise in the total of those employed is governed by Parkinson’s Law and would be much the same whether the volume of the work were to increase, diminish or disappear. (Parkinson, 1957, p. 4)

The lack of a clear definition of property rights also contributes to inefficient allocation of resources. Because the resources put to work in the production context do not belong to the bureaucrat, who is only their keeper or protector, the bureaucrat can use them

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<sup>8</sup> Even if the bureaucratic organization can draw on existing market information, and refer to certain relative prices, it is unlikely that this information will be used correctly within an organization that is fundamentally committed to dispensing with it.

with discretion. Lipsky has convincingly shown how the bureaucrat uses his discretionary power and relative autonomy to divert implementation of a given policy for his own benefit (Lipsky, 1980, pp. 13ff.). Blau's studies of bureaucratic organizations also point out how the bureaucrat can obstruct performance measurement and tweak the indicators (Blau 1955, p. 43). Blau also underscores the importance of the structuring of the links between superiors and subordinates. Employee collusion can lead to use of resources to the disadvantage of the end consumer, and in addition produce mechanisms of resistance to change. Without ownership rights, there is no relationship between performance and remuneration; hence, agents have no incentive for efficiency. The impossibility of appropriating for oneself the profit that could result from improved allocation of resources sterilizes the potential for effort, mobilization, and imagination that bureaucrats could bring to their productive activity. Likewise, the lack of real property rights leads to a dissolution of the notion of responsibility in situations in which prejudice is caused to third parties in the utilization of collectivized resources (Norman, 2003, ch. 8).

Thus, inefficient allocation takes the form of inevitable wasting of resources and results in characteristic problems relating to the *supply* of bureaucratic goods and services. It is, in addition, exacerbated by pressures coming from the users, and thus relating to the *demand* for bureaucratic goods and services. Given the particular pricing mechanisms applied to the goods and services in question—some goods offered at low prices, others provided free<sup>9</sup>—users are encouraged, when these goods and services meet their requirements, to ask for greater quantities than they would ask for in a free-market situation. This artificial, relatively intense demand inevitably generates tensions between supply and demand and, more particularly, shortages of the desired goods and services, so that not all consumers can be served. Shortage also leads to a deterioration in the quality of the good or service. Playing a core role in this rationing process, the bureaucrat acquires power over

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<sup>9</sup> For Niskanen, the financing of productive bureaucratic activity comes essentially from a source other than the sale of what is produced. However he draws no conclusion regarding demand by users, restricting himself to conclusions regarding the conditions of supply which he sees as better than those prevailing on the free market.

the users. In the context of resource allocation, he can resort to such strategies as queuing, redefinition of eligibility, and the imposing of psychological costs—stigmatization, for example (Lipsky, 1980, ch. 7). However, these mechanisms rarely suffice to resolve the problem, which is inherent in the pricing of bureaucratic goods and services.

The well-known inefficiencies of government operation are not empirical accidents, resulting perhaps from the lack of a civil service tradition. They are *inherent* in all government enterprise, and the excessive demand fomented by free and other underpriced services is just one of the many reasons for this condition.... [F]ree supply not only subsidizes the users at the expense of nonusing taxpayers; it also misallocates resources by failing to supply the service where it is most needed. The same is true, to a lesser extent, wherever the price is *under* the free-market price. (Rothbard, 1993 [1962], p. 820)

## DESTABILIZATION AND DESTRUCTION OF MARKET FUNCTIONING

Waste and inefficient allocation of resources are consequences whose effects are limited to the zones of intervention of bureaucratic organizations. Another consequence is impairment of free-market functioning.

In a free market, errors by an entrepreneur in interpreting and anticipating market conditions inevitably mean that he suffers a loss. The profit and loss system is the yardstick needed for determining the implementation and the economic viability of production plans: the entrepreneur must satisfy the consumers who comprise the market if he is to ultimately make a profit, and his errors are sanctioned by losses (Mises, 1983 [1969, 1944], p. 39). Thus the profit and loss system serves as an indicator of sound business management. In the absence of economic calculation, however, bureaucratic organizations are condemned to errors whose extent they have great difficulty in controlling. Furthermore, they lack the means to correct them quickly. The increasing number of bureaucratic organizations implies a rise in the quantity both of errors—because there are more decision-making centers—and of problems of coordination between these organizations. The combination of these two factors leads to “error clusters” (Hülsmann, 1998, p. 11), with the size and number of the clusters constituting

the true measure of the inefficiencies generated by bureaucratic management of a society's resources. The different bureaucratic interventions give rise to "centers of calculational chaos"<sup>10</sup> which block consumer satisfaction and the creation of profit. These centers of chaos spread the distortions they produce to all the interconnected markets within the economy. In this way, bureaucratic interventions and manipulations contaminate the market economy as a whole and impair its functioning.

For each governmental firm introduces its own island of chaos into the economy; there is no need to wait for full socialism for chaos to begin its work.... Thus, any governmental operation injects a point of chaos into the economy; and since all markets are interconnected in the economy, every governmental activity disrupts and distorts pricing, the allocation of factors, consumption/investment ratios, etc.... The greater the extent of government ownership, of course, the more pronounced will this impact become. (Rothbard, 1993 [1962], p. 826)

Consequently, the impact of bureaucratic management is not limited to the sphere of the bureau, but more broadly affects the functioning of other markets, to which the distortions produced on the initial market are transmitted. Market interdependence, on which efficiency depends, thus becomes a vector for the propagation of incorrect information, which leads certain entrepreneurs to opt for production plans that are either not viable or artificially supported. The extent of the distortions induced in markets external to the sphere of bureaucratic intervention depends both on the intensity and duration of the initial intervention and on the proximity of the market in question to the sphere of intervention.

## **DESTRUCTION OF THE ENTREPRENEURIAL FUNCTION**

The appearance of errors, and the inability to correct them or to limit their proportions, results, of course, from the impossibility of applying an economic calculation procedure to the plans being implemented. These errors are also the product of a social process of destruction of entrepreneurial skills: not only do bureaucratic

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<sup>10</sup> The centers of calculational chaos are organizations or segments of organizations whose functioning is not based on economic calculation and engenders distortions in market functioning.

interventions distort market functioning, they also produce pressures that cause the disappearance of vital business skills. The entrepreneur is a key element in the reception of information produced and transmitted by the market (Kirzner, 1997, p. 67). His role consists in processing the information and translating it into appropriate decisions. Extension of the bureaucratic sphere leads to a gradual transformation of real businessmen working under the profit and loss system into bureaucrats obeying rules laid down by a higher authority (Mises, 1983 [1969, 1944], p. 53). In this way bureaucratization profoundly modifies market functioning, as government interference opens up opportunities for a new kind of “political” entrepreneur (Facchini, 2006, pp. 265ff.). As government activity increases in the business world, what comes to count is no longer consumer satisfaction, but staying on good terms with the political authorities. Mises uses the term “adventurers” for this new category of entrepreneurs, whose existence hinges on obtaining political favors and ensuring advantageous interventions and rulings (Mises, 1983 [1969, 1944], p. 79). Herbener takes Mises’s argument further, emphasizing that the market process not only selects the most effective entrepreneurs, but also makes their function more specialized, and thus tends to optimize management of uncertainties and coordination between the plans of the market’s different players. The introduction of bureaucratic procedures leads to distortions in the selection and specialization of entrepreneurs and, gradually, to the sterilization of their skills—even to the total elimination of those skills in a collectivized economy (Herbener, 1992, pp. 82–88). Consequently, the spread of bureaucratic regulation is nothing less than an attack on the foundations of the market economy, and proves deleterious to the supply of the entrepreneurial skills required to ensure sound allocation of resources (Baumol, 1968, p. 69).

## **ORGANIZATIONS WHOSE FUNCTIONING IS DIFFICULT TO MONITOR**

There are several reasons (all resulting from the impossibility of economic calculation and the absence of clearly defined property rights to public production) why the bureaucratization process is difficult to monitor. These reasons are of two kinds: The “internal”

reasons are those that spring from the logic of bureaucratic organization, and that relate to the supply of bureaucratic goods and services. The “external” reasons are those that spring from the functioning of the regulated market in question, and that relate to the demand for bureaucratic goods and services.

### ELEMENTS OF INTERNAL DYNAMICS

The bureaucrat possesses better information about the productive process and its costs than the other parties (agents from other departments, politicians, citizens, lobbies, etc.) concerned in the production of goods. He is also out of range of consumer appraisal in that production is not subject to market evaluation. These two factors provide the bureaucrat with a certain freedom to serve his own interests, and they engender a demand for bureaucratic production that comes from the bureaucracy itself. This demand involves, among other things, either obtaining supplementary budgets or protecting existing ones, depending on the constraints of budgetary procedures and finances (Dunleavy, 1985). These supplementary budgets can have different uses: the hiring of additional staff, pay raises for employees, the obtaining of specific advantages in terms of working conditions, careers, reputations, etc. However these advantages can only be preserved when budgets are large enough (or increasing fast enough) to be widely distributed and thus ensure the organization’s collective defense.<sup>11</sup> The bureaucracy’s organizational configuration makes it possible for bureaucrats to work for the continuation and growth of their advantages. Thus they benefit from their special position, even if its scope is limited by the organizational costs of collective action and the distribution of the consequent advantages (Olson, 1982, p. 72). A further constraint on the obtaining of these advantages lies in the monitoring measures taken by other departments and in competition from other bureaucracies bent on preserving their

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<sup>11</sup> If the budget is constant, one way of obtaining better working conditions is the cutting back of individual production. This means that for the same output unit, employees are better paid. Productivity being hard to determine—because of the difficulty of obtaining information and the impossibility of settling on a market value for the product—employees have at their disposal a relatively easy means of adapting their productive behavior.

own interests (Niskanen, 1994 [1971], pp. 40–41). However, these checks are only partial, for they are grounded more in objective rivalry between bureaucracies over aims and access to resources (resulting from the lack of property rights) than on any actual capacity to monitor output quality and cost (such monitoring being impossible because of the lack of economic calculation). Bureaucrats see their demand for substantial budgets as justified by the need to serve their own conception of the public interest. This conception seems to them self-evident and overriding, given the functions they fulfill: they consider themselves in this respect as possessing a superior knowledge, which authorizes a kind of capture of the citizen by the bureaucrat (Tullock, 1976, p. 35). The citizen, for his part, cannot assess proposed spending plans because economic calculation is impossible (Mises, 1983 [1969, 1944], p. 52). In addition to the specific production configuration inherent in the holding of a monopoly, the bureaucrat gains an advantage from the information asymmetry between the bureaucrat and his sponsor on the one hand, and between the bureaucracy and the citizens on the other (Niskanen, 1994 [1971], ch. 3). He has scope for negotiation based on modulation of his production efforts: by adopting more or less efficient forms of behavior, bureaucrats can negotiate discretionary services that allow them to influence production levels (Breton and Wintrobe, 1986 [1982], p. 7). The informational asymmetry and discretionary behavior syndromes are also to be found in private companies, but they confer special power on their beneficiaries within bureaucratic organizations because the lack of resource ownership rights and the impossibility of economic calculation render the means of checking them inoperative.

The bureaucrat's ability to resist change and increase his prerogatives comes from the political power which he wields and which he represents. The political aspect cannot be ignored since there is no market procedure for the orienting of bureaucratic decisions. As Mises asserts, "bureaucratic management means, under democracy, management in strict accordance with the law and the budget" (Mises, 1983 [1969, 1944], p. 47). The political dimension of public-sector production is a crucial lever for the bureaucrat, who is able to defend his interests not by generating citizen satisfaction, but by using his political weight. Indeed, the bureaucrat

simultaneously holds the post of employee and employer, and for this reason he has every interest in insisting on higher budgets.

The bureaucrat is not only a government employee. He is also, under a democratic constitution, at the same time a voter and as such part of the sovereign, his employer. He is in a peculiar position: he is both employer and employee. And his pecuniary interest as employee towers above his interest as employer, as he gets much more from the public funds than he contributes to them.

This double relationship becomes more important as the people on the government's payroll increase. The bureaucrat as voter is more eager to get a raise than to keep the budget balanced. His main concern is to swell the payroll. (Mises, 1983 [1969, 1944], p. 87)

As the first to be affected by a given government policy, the bureaucrat certainly stands to benefit from promoting demand for bureaucratic goods and services; thus his post represents a private income sometimes made easier to obtain by political loyalty or affiliation (Rothbard, 1995). As a result, the bureaucrat vote carries weight in the electoral process by influencing official attitudes towards bureaucratic activity (Tullock et al., 2002, p. 54). A change from profit-seeking output to bureaucratic output of goods and services implies not only a change of decision-making modality, from a system of relative prices to one of rules, but also a shift in the very nature of the decision, from economic to political. The effect of this dual change is a radical transformation of the function of the bureaucracy and of the goal of public-sector policy. The former no longer solely consists in the implementation of political decisions regarding the production of goods and services; it also becomes a political issue in that it plays a part in the distribution of private incomes (Tollison and Congleton, 1995). The bureaucratic organization is no longer simply an instrument for executing public-sector intervention. It is also a mechanism for determining the nature and degree of such intervention. In brief, it is no longer exogenous to the political system. It has progressively become endogenous.

The functioning of bureaucracy is also affected by the determinants of the supply of bureaucratic goods and services. The resources used by bureaucratic organizations are not subject to market evaluation and do not accrue from the sale of prior productive services. The state can obtain resources through the

privilege of creating money, of which it has the monopoly, or by coercive taxation policies. Public loans are a third financing alternative, with repayment conditions open to state manipulation via inflation or taxing of the interest paid. A last solution consists in directly using physical resources without paying the market price, as in occupation of property, conscription, technology transfers, etc. (Niskanen, 1998, p. 53) All in all, the cost of obtaining funds for financing the productive activities of bureaucratic organizations turns out to disregard that prevailing on the free market. The explanation for this inadequate valuation of the resources employed in the bureaucratic production cycle lies in an artificial diminution of the opportunity cost of access to them (Rothbard, 1993 [1962] p. 821). Not only is the bureaucrat not encouraged to make careful use of resources, he also has a tendency to use more of them than he really needs and to always ask for more, which leads to an increase in the size of bureaucratic organizations. At the organizational level, bureaucracies demand steadily increasing budgets for the carrying out of their productive tasks.<sup>12</sup> The lack of evaluation by the market removes the pressures for sound use of resources and, because of a higher temporal preference for the present, also removes the brake on their rapid acquisition (De Alessi, 1969, p. 18). This mechanism encourages a tendency to overspend, while the lack of real rights of ownership further tends to weaken those mechanisms that encourage preservation and evaluation of the assets being expended. The wise bureaucrat would maximize returns on the use of the resource he controls, rather than making choices over too long a period, from which it is not certain that he will recoup the anticipated outcome. This effect is amplified by the political issues sometimes associated with it, as temporal horizons turn out to be brief and uncertain (Rothbard, 1993 [1962], pp. 828–29; Niskanen, 1994 [1971], pp. 116–19).<sup>13</sup> Thus, those in charge of bureaucratic organizations are encouraged to multiply their spending plans. Where necessary, they mortgage a part of the

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<sup>12</sup> This is not to say that they get what they ask for.

<sup>13</sup> “The private individual, secure in his capital ownership, can afford to take the long view because of his interest in maintaining the capital value of his resource. It is the government official who must take and run, who must exploit the property quickly while he still in command” (Rothbard, 1993 [1962], p. 829).

future, limiting the capacity for future borrowing by forcing their successors to ensure the financing of earlier measures.

## THE EXTERNAL DETERMINANTS OF BUREAUCRACY

A consideration of factors exogenous to the bureaucratic organization contributes to better understanding of its dynamics and its growth. If we accept the idea that bureaucracy is one of government's favored means of intervention in the social system, then an explanation for the extension of bureaucracy is to be looked for in the patterns of the extension of governmental intervention. Downs's explanation suggests that demographic growth, the complicating of social relationships, and the rise of technology in prosperous societies are the sources of bureaucratic expansion (Downs, 1994 [1966], pp. 256–57). Attempts at income redistribution, ideological reasons, and political crises are seen as justifying state intervention (Peltzman, 1980; Higgs, 1987, ch. 1). Thus there are many competing explanations for bureaucratic expansion, and no one theory really compels acceptance.

The theory of bureaucracy proposed here suggests that the lack of ownership rights and the impossibility of economic calculation are the two factors vital to an analysis and an understanding of these distinctive organizations. The combination of the two allows for the transfer of the production of goods and services at no cost or at a price well below that of the market—a pricing system that ensures that the supply of goods and services will meet with sustained demand. This pricing policy for bureaucratic goods and services thus leads to the creation of tensions between supply and demand via the emergence of shortages. The generally accepted remedy for this situation is not the requirement of payment for service, or an attempt to establish an appropriate price, but an increase in the quantity of resources devoted to production, together with increased spending and growth of the bureaucratic production structure. Consequently, the pricing policy applied to bureaucratic goods and services stimulates and maintains artificially high demand, which in turn justifies greater bureaucratic intervention.

Many grave consequences follow from the split and from the “free” service as well. As in all cases where price is below the free-market

price, an enormous and excessive demand is stimulated for the good, far beyond the supply of the service available. (Rothbard, 1993 [1962], p. 819)

The distinctive financing conditions of bureaucratic organizations support their expansion in two ways. The ready access to inexpensive resources outlined above makes it easy to respond to citizens' calls for additional production (Niskanen, 1998, p. 53). The resources obtained do not depend on sales and the satisfaction of client needs, and bureaucratic structures can all the more comfortably meet needs since for them, access to resources seem less restrictive and access to public markets more privileged than for private firms. This privileged access to resources and public markets gives bureaucratic organizations an advantage over private firms when the two sectors are in competition for the production of services. Private companies have trouble competing with bureaucracies because the difference in production costs and pricing policy leaves them with little competitive edge (Rothbard, 1993 [1962], p. 823). Thus the conditions of public-sector production and distribution favor the expansion of bureaucratic organizations, to the detriment of private entrepreneurs, who must contribute to the financing of the bureaucracies and also cope with unfair competition.

Moreover, bureaucratic supply of goods and services has a self-generating effect: the failure of public interventions justifies fresh interventions intended to compensate for and correct the shortcomings of the preceding ones, and bureaucracy is the favored tool of government intervention. Mises notes, "In this as in many other instances the bureaucrats see in the failure of their measures a *proof* that further inroads into the market system are necessary." (Mises, 1983 [1969, 1944], p. 35)

The consequence is that new bureaucracies must appear, or the original ones must expand. The failure of public intervention is often interpreted as due to either insufficient funding or the use of inappropriate intervention tools or mechanisms, this latter being seen as justifying the creation of new organizations or the reorganizing of existing ones. It should be pointed out here that this model provides a unique explanation for the growth of bureaucratic structures. This growth can take the form of increases in the sizes and the budgets of existing structures, but the bureaucratization

phenomenon can also lead to a proliferation of new structures that has nothing to do with the growth of earlier ones. In short, bureaucratization can take place via external growth (proliferation of organizations) or internal growth (increased budgets), or both.

Although bureaucratic failures are systematically interpreted as resulting from a lack of funding or from the use of an inappropriate intervention structure, Mises has convincingly shown that these failures in fact result from the absence of economic calculation. This means that the new public-sector solutions set up to counter previous mistakes are also doomed to failure and are going to justify still further interventions (Ikeda, 1997, ch. 5). Thus there exists a dynamic that is specific to bureaucratic production and the ongoing growth of bureaucratic structures within economic systems. This dynamic results partly from ideological preconceptions regarding the supposed superiority of public-sector organization of production (Higgs, 1987; Mises, 1994 [1972, 1956]; Blake, 1991) and partly from the self-sustaining mechanisms of bureaucratic growth.

A third reason why bureaucratic organizations expand is that they destabilize free markets. Public intervention creates centers of calculational chaos, whose destabilizing effects, given the interdependence of the different markets, spread to the economy as a whole (Rothbard, 1993 [1962] p. 826). By producing localized distortions in market functioning, resource allocation is modified and the negative effects multiplied. The initial intervention produces a string of destabilizing effects, which are then amplified by feedback effects. Although this destabilization stems from inappropriate bureaucratic interventions and can only be corrected by returning to free-market functioning,<sup>14</sup> in practice it is used to justify further interventions, this time in economic spheres hitherto spared from governmental intrusion.

These measures were needed because previous government interference that paralyzed the operation of the market resulted in paradoxical and highly unsatisfactory conditions. Not the insufficiency of the market

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<sup>14</sup> There is a kind of paradox here. The interconnectedness of markets is a strength for market functioning in that, among other things, it facilitates adjustment by market participants, but it also serves as a vector for propagation of public interventionism by allowing destabilizing effects to proliferate. Thus the underpinnings of the market are attacked from within.

mechanism but the inadequacy of previous government meddling with market phenomena made the priority system unavoidable. (Mises, 1983 [1944], pp. 34–35)

And so bureaucracy, through a form of “historical trickery,” is able to pass off failings of the public-sector as an inability of the market to satisfy needs expressed by consumers. What happens is that bureaucratic management generates public frustration, which gradually takes the form of hostility to market mechanisms, and consumers’ ideological preferences evolve towards governmental solutions (Ikeda, 1997, pp. 24–25). Mises sees in this process a denial of the lessons of economics, as well as what he calls bureaucratization of the mind (Mises, 1983 [1944], pp. 88–89), and above all the ongoing erosion of consumer sovereignty by authoritarian decisions coming from the various bureaucratic organizations (*ibid.*, p. 43). Consumer frustration can also be caused by recurring shortages, themselves basically determined by conditions of access to the goods and services on offer. Consumers will not be served and will not have access to what is produced. Furthermore, the lack of economic calculation makes it impossible for bureaucratic structures to produce goods and services that meet consumer requirements. In terms of diversity, bureaucratic production stands revealed as crude and second-rate, as a direct consequence of its inability to deal with the complexity and variety of demand.

Lastly, the proliferation of centers of calculational chaos leads to a reduction of output by private companies and a decrease in social utility (Rothbard, 1993 [1962], p. 826). Some producers find themselves excluded from certain markets because their field of activity has become unprofitable, while others cut back production in response to redistribution mechanisms that undermine investment policy, and interventions that harm labor market functioning (Mises, 1985 [1944], ch. 4; Rothbard, 1993 [1962], p. 823). In addition, bureaucratic interference makes private-sector businessmen dependent upon and submissive to political decision-makers. This process gradually destroys the role of the entrepreneur.

## CONCLUSION

The economic theory of bureaucracy presented in this article holds that the lack of property rights and the impossibility of real

economic calculation are two essential characteristics of bureaucratic organizations. Thus the theory is clearly distinguishable from its predecessors that are based on analysis of the internal functioning of bureaucratic organizations, and that give primary importance to the information asymmetry between the bureaucrat and the sponsor (Niskanen, 1994 [1971]), or to the arbitrary behavior of bureaucrats (Breton and Wintrobe, 1986), or to power relationships (Tullock, 1965). Although the theory presented here takes inspiration from the earlier work of Mises (1985 [1944]), it differs markedly in its emphasis on the importance of clearly identified property rights. It differs, too, in restricting its field of study to the economic consequences of the existence of bureaucratic organizations.

There are convergences between this theory and its predecessors with respect to the consequences produced by bureaucratic structures—inefficient allocation of resources, budgetary manipulation, and impairment of market functioning—but the initial postulates are so dissimilar that it must be doubted whether a synthesis would be feasible.

This theory is a first attempt at analyzing bureaucratic organizations. Further work is needed on the overall political and social consequences of such organizations, on their internal dynamics, and on bureaucratic network effects in the context of mixed economies: complementarity, replacement, and rivalry between different bureaucracies and between bureaucracies and private enterprise. In brief, this theoretical initiative opens up new research prospects, which will doubtless enable a more nuanced understanding of the distinctive structures that lie on the frontier between economics and the politics.

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