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Use of “Market Testing” Competitive Bidding to Tighten Scrutiny of Government Actions

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One of the research themes being pursued by the Japan Center for Economic Research during the current fiscal year concerns analysis of the proper approach to government activities from the perspective of medical services, education, welfare, pensions, municipality mergers, the roles of the central government, the central bank and other angles. From within this theme, I am studying the means of maintaining reliable scrutiny over government and administrative functions. In this report, I briefly describe why government tends to swell in scale, and then explain the potential for the “Market Testing” (public-private sector competition), an approach that introduces the competitive principle in evaluating administrative and policy costs, to become a key for curbing the trend toward big government.

The “Principal-Agent Theory”

Within the discipline of economic science, the relations between government and taxpayers are treated as an area that involves the “principal-agent theory”. This formula is easier to grasp if we consider the principal (or “client”) to consist of the voters, and the agent (or “representative”) to be civil servants in the broad sense of the word (including legislators and prefectural governors as well). It is possible, furthermore, to apply this equation to the relationship between shareholders and management that exists at companies.

The key question here is whether or not the agent acts in the way desired by the principal. Within companies as well, there are frequent examples of management adopting actions that fly in the face of the interests of shareholders. Compared to governments, however, the goals that need to be pursued by corporate agents are comparatively clearly stated in the form of improvements in profits, stock price and so forth. It is also possible to devise means, such as paying the management (agents) stock options, to ensure that the interests of the shareholders and the management are in fact one and the same.

The Barrier of the Public-Private Information Divide

With regard to government, however, difficulties rapidly emerge with regard to forming judgments on the specific goals to be targeted. In the first place, it is for the very reason that the goals of government do not generate profits, are not impacted by market

mechanisms and present difficulties in being subjected to evaluations from cost, profit and other perspectives that they are implemented as public policy. Likewise, there is limited understanding of the cost of such policies, including labor outlays and other indirect spending. It is in this area, therefore, that schemes differing from those of the corporate sector become necessary.

Returning to the “agency problem,” in economics the accepted theory is that actions by agents contradictory to the interests of principals occur at times when “information divides” exist between the two sides.

Even when the intentions of both sides differ, if it is possible for the principal (citizens) to maintain the same degree of knowledge regarding administrative issues as the agent (civil servants) and obtain the same degree of administrative information, it will also be possible to scrutinize the civil servants. Stipulations may then be established to assess penalties if the interests of citizens have in fact been compromised.

However, considering the actual state of government, it is extremely difficult to bridge the information divide between citizens and civil servants. This is because the costs of resolving such disparities in intelligence are normally too great for citizens to bear.

There is no truly reliable way for normal citizens to know whether or not civil servants are carrying out only the operations that are truly necessary at the minimum cost. Even if regulations are established in advance, it is simply not possible to set forth the details of those rules so that citizens and civil servants occupy equal positions. As a result, there is a tendency toward “administrative bloating” in which the government ends up taking on numerous operations that do not appear to be all that necessary.

One of the factors behind the swelling of government phenomenon lies in the evaluation system for civil servants. For individual civil servants, who do not work for performance-based pay as such, increased workloads have never been viewed as the best plan. The fact that workloads are often raised in spite of this reality is because in the majority of cases the “performance” of civil servants is assessed on the yardstick of quantity and not quality. While reducing the volume of work and raising administrative efficiency is difficult to treat as a target for evaluation, the far more graspable reality of securing a budget and then expanding the workload within that framework is fairly easy to apply as an assessment benchmark. The difficulties that citizens (clients) encounter in performing evaluations on the details of budgets or administrative operations have accelerated these conditions.

Undertaking Government Governance from Cost Revisions

As noted above, there is an inherent inclination for government to deviate from its position as an agent of the citizens. There are various systems that exist for the sake of empowering citizens to exercise governance over administrative functions – including the information disclosure, citizen’s lawsuits and other means. Despite having such structures

in force, however, the difficulties in readily obtaining information about government affairs render it difficult to curtail the trend for civil servants to shun their duties. A particular source of trouble lies in the difficulties involved in properly evaluating the cost of administrative activities.

One means with the potential for engineering improvements on this front is the “Market Testing” approach, being introduced of late, which involves the introduction of public-private sector competition. In a word, the Market testing system involves having both public and private sectors bid from equal footing for projects and operations undertaken by the government, forcing them to compete against each other and thereby raise the level of administrative efficiency.

The public sector is under pressure to lower costs in order to protect its own work. If it becomes possible for private companies to enter the picture, the trend for government to strive to undertake work in fields where there is no essential need for its services will be eased, with this also acting to curb the bloating of administrative ranks.

The sphere for introducing the Market testing system remains limited. However, when evaluating costs in fields where the approach has yet to be introduced, comparisons may be made with fields in which it is introduced and other applications as an indirect guideline. In this way, this system harbors the potential to provide clues in revising overall administrative costs.

As a function, the Market testing system does not work to lower administrative costs as such, but rather acts in a secondary capacity as a means of reducing the time and effort required in obtaining information on administrative costs. In this sense, it can be said to be a systematic method of mobilizing the autonomous activities of both the public and private sectors to narrow the information divide that effectively prompts the agency problem.

Administrative governance is an area that faces numerous difficulties. The combining of information accrued through the Market testing approach with the various administrative governance methods already in force offers an important means of strengthening civilian level scrutiny over government actions.

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