Commentary

Danger, Chimeras Ahead: Comment on Terry

Howard L. Frant, Haifa University

A recent article by Larry Terry raises the alarm about a new management ideology, which he calls "neo-managerialism." He says that this new ideology, a compound of several recent management theories inspiring the reform movement known as the New Public Management, is "a serious threat to democracy" (1998, 198). In fact, though, the ideology described by Terry does not exist. Terry misinterprets the theories he describes, which are extensions of traditional concerns in public administration. Public administration scholars should not fear these theories, but welcome them as giving us new insights into the way organizations do and can work.

Terry views neo-managerialism as being based in part on the old managerialism, one of whose tenets is that "managers must be granted reasonable 'room to maneuver....'" This certainly sounds like an idea associated with New Public Management, and as evidence Terry mentions the 1993 Gore report, which refers to U.S. federal managers as "good people trapped in bad systems." The bad systems, explains Terry, are viewed as "overburdened by a plethora of cumbersome and unnecessary rules, regulations, and other constraints" (1998, 195).

But what makes neo-managerialism new, according to Terry, is that the old managerialism is combined with organizational economics (agency theory and transaction-cost economics) and with public-choice theory. And what do the latter theories say? According to Terry, they say that "Public managers require extensive policing... for they cannot—and should not—be trusted" (1998, 196). These theories supposedly "assume that public managers are inclined to cheat, lie, and engage in other opportunistic behaviors" (1998, 198).

Neo-managerialism as presented by Terry, then, is a strikingly bizarre ideology, for its two main pillars, the managerialist pillar and the economics pillar, stand in direct contradiction to each other. The former says managers must be freed from constraints, the latter says that they require extensive policing and cannot be trusted.

Two alternatives immediately come to mind: that the theorists of the New Public Management are completely befuddled, or that Terry has misunderstood something. I will argue below that the second alternative is correct. Terry himself, however, tries a third alternative, with unfortunate results. Terry's approach is to treat the positive statements of organizational economics, about how managers might behave, as normative statements, about how they should behave. Thus, according to Terry, neo-managerialism not only asserts that managers should be freed of constraints, as the old managerialism did, but that they should be self-interested and opportunistic (1998, 197). One could hardly help finding such a prospect frightening: self-interested managers running wild, glorying in their opportunism.

This is, however, a complete misunderstanding of what organizational economics is about. Agency theorists do not, as Terry seems to think, celebrate self-interested behavior by managers; rather, they refer to such behavior as agency "problems." To the extent that these theorists have a normative goal, it is to prescribe solutions to such problems. By trying to combine organizational economics and managerialism into a single normative philosophy, Terry has created a chimera, in both senses of the word ("an imaginary monster compounded of incongruous parts" and "an illusion or fabrication of the mind"). This monster would, indeed, be frightening—if it existed. Let us agree that a normative theory advocating complete freedom for opportunists is not one we wish to adopt, give thanks briefly that no one is advocating such a theory, and move on.

It remains to be discussed how organizational economics and managerialism can usefully be combined, for Terry is correct in noting that both have played a role in the development of the New Public Management, notably in New Zealand (Boston, 1991a; Thompson, 1997). How can such seemingly incompatible beliefs be reconciled?

The View of Organizational Economics

First, what do organizational economists believe about managers? Certainly not the caricature sometimes presented by their antagonists, and now repeated by Terry. Terry does not quote any exponents of organizational economics (e.g., Jensen and Meckling 1976; Williamson 1985) in summarizing; instead, he quotes those who are hostile to it (e.g., Donaldson, 1990). I do not think an agency theorist can be found who says what Terry claims they say: that managers are "opportunistic, deceitful, self-serving, slothful, and adept at exploiting others." (1998, 197).

What, then, are the distinguishing
features of an agency model? There is no assumption that managers are depraved egomaniacs. Indeed, we need not be talking about managers at all. Agency models can be used in any situation where one person, the agent, is taking some action on behalf of another, the principal. The essential characteristics of such a model are that: (a) the actions of the agent cannot be perfectly observed by the principal; (b) the interests of agents and principals will sometimes diverge; and (c) when that happens, agents will sometimes follow their own interests. Could these statements apply to the relation between politicians as principals and public managers as agents? Of course; what serious student of public administration would disagree? But they could also apply to the relation between citizens (as principals) and politicians (as agents), as well as to that between clients (as principals) and HMOs (as agents), between insurance companies (as principals) and insured parties (as agents), and so on almost ad infinitum. Note that, contrary to Terry's assertions, agency theory can be applied quite well to situations where both principal and agent are motivated by the public interest, as long as principal and agent have somewhat divergent conceptions of what that public interest is.

**Reconciling Organizational Economics with Managerialism**

Certainly, however, a principal-agent perspective implies that at the politician-manager nexus, as at many others, compliance with the principal's wishes cannot be taken for granted. We are still left with the problem of how to reconcile this view with the managerialist assertion that stifling restrictions on managers should be lifted.

But there is less contradiction here than might appear. It is intrinsic to the principal-agent relationship that agents have better information about some things than principals do. This may be because of simple division of labor—principals hire agents in part to spare themselves from having to be well informed about the details of operations. Or it may be that the principal hires the agent because of the latter's superior expertise.

In either case, it is unlikely that the principal will have the knowledge necessary to specify in great detail what the agent should do, without incurring a serious cost in lost effectiveness. So simple restrictive rules are not a generally satisfactory solution. It is just this that makes agency problems challenging. And it is this that makes the application of agency theory to the public sector so important, for it is in the public sector that the cost of detailed constraints on managers seems least considered.

Organizational economists, then, have not in general advocated increased constraints on managers as a way to control agency problems. Rather, they have considered alternative approaches, two of which are important to discuss here.

One is to improve principals' ability to monitor agents. In the jargon of the New Public Management, this is referred to as improving "transparency." For example, full accrual accounting gives a truer picture of resource use than does standard government accounting in the U.S. and thus helps make operations of government more transparent to both politicians and citizens.

Similarly, if senior managers sign written output contracts with politicians, as in New Zealand (see Boston, 1991b), transparency is improved over a system where they are given unclear and conflicting mandates. Note that it is not just managers who are better monitored in such a system. At least as important, the actions of politicians become more transparent as well. Written performance contracts make it more difficult for politicians to blame their policy failures on bureaucrats; if the manager met the goals and there is still a problem, the problem lies with the policy.

These issues are by no means unfamiliar to students of public administration. The long-standing concern of the public administration literature with "accountability" turns on just such issues. One simply would not care about accountability if one believed that divergences of interest between citizens and public officials were not significant. But accountability is a rather slippery term—who is accountable to whom, and what increases or decreases accountability? The issues become more concrete when we talk about the principals' ability to monitor agents.

**When Accountability is Not Enough**

Improving monitoring is not the only approach the principal-agent literature takes to solving agency problems. An even more common approach is to seek ways to align incentives of agents with principals' interests. In the private sector, for example, one might ask whether managers' responses to takeover attempts are different if managers are themselves considerable stockholders. Here, stockholders are principals, managers are their agents, and the question for principals is whether managers are helping stockholders by resisting a takeover, or merely preserving their own jobs. Giving managers considerable stock ownership may help align their interest with those of stockholders, by insuring that they will profit if other stockholders do (Berle and Means, 1933; Megginson, 1997).

The option of paying managers in stock does not, of course, exist in the public sector, but incentive alignment remains an important question. As the New Zealand Treasury observed in one of the opening salvos of the New Public Management literature, "Incentives matter.... Well designed policies will align the interests and actions of individuals with those of the nation" (1987, 2). The design of public institutions often has dramatic effects on incentives of public officials.

For example, a point well known to anyone familiar with public-sector budgeting is that requiring managers...
to return unspent funds at the end of the year gives them an incentive to spend wastefully. Few budget officials would be quixotic enough to rely solely on managers’ public-interest motivations to overcome this problem, especially since managers’ interpretations of the public interest are likely to be rather different from the views of budget officials. Rather, budget officials tend to rely on restrictive mechanisms, such as allotments. Osborne and Gaebler (1992), however, point out that we can change the incentives, and thus the behavior, of managers simply by allowing agencies to retain some fraction of unspent funds. If the fraction is reasonably large, the incentive for wasteful spending is greatly reduced. Such a strategy is not without costs, but the same is true of any alternative.

Nor is it only managers whose actions may usefully be aligned with the public interest through appropriate incentives. For example, when government operations are not very transparent to citizens, politicians may have an incentive to defer spending on items with visible costs and less visible benefits, such as maintenance of infrastructure. If capital-intensive operations, for example water systems, are made financially self-supporting, the incentive structure is changed in ways that may result in more maintenance spending (U.S. General Accounting Office, 1980; Peterson and Miller, 1982).

Notice that in this case, an agency-theory perspective gives us a somewhat broader perspective than we would get from a conventional accountability view. The latter would probably tell us to centralize responsibility and budgeting in order to clarify accountability and make fiscal tradeoffs more explicit. But when operations are not very transparent by their nature, accountability may be hard to come by. Citizens may have great difficulty, and little interest, in monitoring the condition of, say, water systems. Agency theory suggests that here, incentive alignment can be a substitute for improved monitoring (Franz, 1996).

Entrepreneurship, Agency Theory, and the Public Interest

Terry is deeply worried by the whole idea of public entrepreneurship, which he views as an unwelcome neo-managerialist innovation. He remarks, “Neo-managerialism fosters the idea that public managers are (and should be) self-interested, opportunistic innovators and risk-takers who exploit information and situations to produce radical change.” In large measure, of course, this is the same chimera we have already seen. Take out the words “self-interested” and “opportunistic,” and it is a reasonable description of the views of advocates of entrepreneurial management. But I am not aware of any advocate of entrepreneurship who argues that managers should be primarily self-interested. Indeed, they sometimes emphasize the personal risks of entrepreneurship. Thus Cohen and Einicke (1995, 254-5) assert:

It is less risky to sit back and wait for events to develop and orders to come from above. Your career may be safer if you act cautiously and carefully measure the direction of prevailing opinion. However, your chances of accomplishing much are greatly diminished by such passivity.

The image of managers in the public entrepreneurship literature is of people motivated by a conception of the public interest. Terry seems quite ambivalent about whether this is or is not a plausible motivation for managers, but such motivations are in no way inconsistent with agency theory. The question is, what justification is there for policy entrepreneurship by public managers? Shouldn’t policy be the province of elected officials?

An agency-theory framework suggests some answers. First, managers will be better informed about how programs look on the ground than elected officials will. Just as one would expect most ideas for product innovation in a for-profit corporation to come from managers rather than from the board of directors, one would expect ideas from program innovations to come from managers rather than politicians, an expectation with some empirical support (Borins, 1998). Second, one cannot assume that politicians themselves will always be perfect agents for citizens. For example, politicians may have incentives to give managers vague and contradictory mandates and to delegate difficult decisions to them (Fiorina, 1985). In that case, managers may have no alternative but to be entrepreneurs (Behn, 1998).

Probably, good public managers have always had to be entrepreneurial, even if academics are only now recognizing it. Rather than lament the fact they are, students of public administration should be thinking about how best to monitor entrepreneurial managers, and how to give them incentives for appropriate behavior.

Conclusion

The issue posed by organizational economics goes to the very heart of public administration in a democratic society: how to make all public-sector agents, politicians as well as managers, responsive to the interests of citizens. How do we make government more transparent to citizens? How can we better align public officials’ interests with those of citizens? These questions are important. We should welcome whatever tools can be brought to bear on answering them.

Notes

1. Henceforth I will use “agency theory” and “organizational economics” interchangeably. Though there are differences between agency theory and transaction-cost economics, their concerns are largely parallel.

References


