Politics and Markets What are they good for?

POLITICS AND MARKETS
What are they good for?

Geoff Airo-Farulla[*]

Neoclassical economic ideology's strength today lies partly in the epistemological claim that markets can process information about people's needs more effectively than can political institutions. Market forces provide a feedback mechanism for market actors that is usually absent for political institutions. On the other hand, political institutions can process important information about people's needs that markets clearly cannot. To do so successfully, political institutions require their own set of feedback mechanisms. Administrative law, with its emphasis on people's participation in government and accountability of government, is an important part of this government learning framework.

Introduction

The question raised in the title is the question of how we can organise our institutions to meet our human needs. Any attempt to answer this question must address an epistemological issue: how, and what, can our institutions know about our needs? The strength of market ideology today lies partly in the epistemological[1] claim that markets can process information about people's needs more effectively than other types of institutions, particularly political institutions. On the other hand, it is clear that political institutions can process information about people's needs that the market cannot. However, this epistemological claim is less well developed for political institutions. Nevertheless, this is why we can use political institutions to decide when to use and when not to use markets, but we cannot use markets to decide when to use and when not to use political institutions.

Liberal discourse, which has near-hegemonic status in popular and academic culture in the West, prioritises the market over political institutions. In this discourse, the market is thought of as the usual, natural or best way of deciding how to use resources. Political institutions, being much less capable and more threatening to liberty, are a necessary evil. They have no intrinsic value, but merely play a subsidiary role to the market, correcting market failures and compelling necessary social co-operation in circumstances where the market fails to provide the right incentives for it. However, I argue that political institutions have an

---

* Lecturer, School of Law, Griffith University, Brisbane

1 'Epistemology' is the study of how humans can know things and what we can know.

intrinsic value, offering us opportunities to meet human needs that markets cannot.

The Market

Basic assumptions

At a conceptual level, 'the market' can be understood as an attempt to answer a good question: how can we organise ourselves to ensure that human society best meets human needs? The form that answer takes is based on certain assumptions and related conclusions.

First, market theory assumes that human needs are simply the sum total of individual needs, and that these needs are best defined by the individuals themselves. It is further assumed that people can, and do, define their own needs, and act to meet them; they are 'rational, self-interested, utility maximisers'.[2] Because needs are best defined by individuals themselves, it is usually further assumed that it is illegitimate to be paternalistic (to claim to know better what a person needs than the person herself), and to impose interpersonal comparisons (to decide that one person's self-defined need is more important than another person's self-defined need).[3]

Secondly, market theory assumes that life is characterised by scarcity: there are not enough material resources available to meet every individual's every need.[4] Therefore, society requires some mechanism for deciding which needs will be met. Further, scarcity means that it is important to get the most out of the resources we have: society best meets human needs when as many individual needs as possible are being met. Economists call this 'allocative efficiency'. An optimally efficient distribution of resources would be one that could not be changed without making at least one person worse off, according to their own self-definition of need. Economists refer to this situation as 'Pareto optimal'.

Thirdly, many market theorists assume (in common with most of the social sciences) that humans have 'bounded rationality'. In other words, there are limits to our ability to find and use information. Amongst other

---

2 'Rational' because we seek the best means to the end of satisfying our needs; 'self-interested' because we only seek to satisfy our own needs, not those of other people; and 'utility-maximisers' because we seek to satisfy our competing needs in a way that maximises our overall satisfaction.

3 As Stewart puts it, economists generally assume that:

> economic rationality is an attribute of means alone, while the ends or goals of economic agents are inaccessible to reason. Any goal is as valid as any other ... and an agent's rationality is assessed only with reference to his or her effectiveness in achieving the goal.

H Stewart, 'A Critique of Instrumental Reason in Economics' (1995) 11 *Econ & Phil* 57, p 58.

Stewart argues that economists must both explore how preferences are formed, and be prepared to evaluate their comparative worth.

4 Particularly if, as is commonly added, self-defined needs are infinite — there is no end to what we think we need: 'more is always preferred to less'.

things, this means that while it is possible for people to communicate their needs to others, it is impossible for any person or institution to know what everybody needs and how to get it to them. Therefore, a centralised system of planned resource allocation must fail to meet people's needs.

Market strengths

Essentially, a market system is a process in which individuals communicate their needs to others (economists call this 'demand' for goods), and in which other individuals decide whether those needs should be met (economists call this 'supply'), or whether the relevant resources should be utilised to meet somebody else's need. In theory, the same thing could be done by a political institution. Indeed, something like this goes on millions of times every day in government welfare agencies. However, market theorists claim that markets do this better than political institutions, for two main reasons. First, market theorists claim that market outcomes approximate Pareto optimal outcomes (the 'efficiency claim'). Secondly, even though markets only approximate Pareto optimal outcomes, and therefore are not perfectly efficient, they must inevitably perform better than political institutions for epistemological reasons (the 'epistemology claim').

The efficiency claim To understand the efficiency claim, it is useful to begin with the idea of a simple exchange relationship, what lawyers call a contract. It seems safe to assume that a freely entered into exchange leaves nobody worse off. If I give you $5000 and you give me your car, it seems clear that I value your car more than I valued my $5000, and similarly you value my $5000 more than you valued your car. The resources (the money, the car) have flowed to where they are more highly valued, making us both better off. If the example is generalised, so that all resource allocations are of the same type, then a Pareto optimal situation will be reached: resources will flow to where, by agreement, they are most highly valued. It would be impossible to alter the resulting resource distribution without interfering with at least one person's self-defined needs, making them worse off.

However, economists recognise that this kind of example can only be multiplied if certain conditions are met. The basic condition is that goods are being sold at prices that are equal to the marginal cost of producing them.[5] If this is not the case, then resources will not flow to where they are most highly valued. If goods are being sold below their marginal cost, then it is clear that they are not valued as highly as the resources ('inputs') being committed to them are valued. In other words, they are not worth their

5 'Marginal cost' is the cost of the inputs necessary to produce one more unit of output. For example, suppose that producing 20 units costs $100, but that 21 units could be produced for $102 dollars. This is likely to occur because certain fixed costs are likely to be the same whether 20 or 21 units are produced. The 21 units cost on average $4.85, but the marginal cost of the 21st unit is only $2. The cost of the necessary inputs includes any physical plant and materials, employee wages and capital costs such as interest payments on loans and dividend payments to shareholders.

'opportunity cost' — the value of the alternative uses to which the inputs could be put — and the inputs would be better deployed elsewhere. Conversely, if goods are being sold at a price higher than their marginal cost, then demand for them will be lower than it would otherwise be.[6] This results in a 'deadweight loss': people who would have purchased the goods, had the price been equal to the marginal cost, refrain from doing so, forgoing the goods' benefits. Meanwhile, the inputs that would have been used in meeting that suppressed demand are diverted to other, less highly valued uses.

Most economists claim that markets operate so as to avoid these kinds of inefficiencies. In a perfectly competitive market, sellers won't sell at below marginal cost, because they can use the resources more profitably elsewhere; and buyers won't buy at above marginal cost, because they can buy more cheaply elsewhere. When this happens, economists say that the market has 'cleared' and is in 'equilibrium'. The conditions necessary for a perfectly competitive market are highly artificial,[7] but the model is intended as an ideal type, not an empirical description of real markets. The model's value lies in its predictive capacity: economists find it is useful because it provides a good guide to what will happen even when not all the assumptions hold. Thus, competitive markets empirically 'tend towards' or approximate efficient outcomes in ways predicted by the model, even if Pareto optimal efficiency is never reached.[8]

---

6 Because of the 'law of supply and demand': if all else is equal, an increase in price will decrease demand and vice versa; while a drop in demand will decrease price and vice versa.

7 The conditions that different authors propose are required for perfect competition in a market for a particular commodity vary around a common core of at least five: (1) everybody is selling homogenous, non-differentiated and completely substitutable commodities; (2) there are a large numbers of buyers and sellers in the market, each accounting for an insignificant amount of the total trade, so that sellers can't determine what price they will sell at but have to accept the price that buyers are willing to offer; (3) there is freedom of entry into and exit from the market for both buyers and sellers, so that if excessive profits are being made, new sellers will enter to drive down price, and if insufficient demand lowers price, new buyers can appear to soak up excess production; (4) all buyers and sellers have access to perfect information with respect to present and future prices and the commodity's location, or (as this contradicts bounded rationality) at least face equal 'transaction costs' in obtaining this information; and (5) there is no collusion between sellers or between buyers to drive prices up or down..

8 This idea of 'allocative' efficiency is based on a static model of the economy, but in fact society is dynamic. Economists claim that competitive markets also create or capture 'dynamic' and 'X-' efficiencies. Dynamic efficiency is achieved by adapting new production technology to meet demands in new, cheaper ways, while X-efficiency is finding ways to increase the productivity of 'human capital' through 'human resource management'.

The epistemology claim Although no market is perfectly competitive or perfectly efficient, market theorists claim that markets necessarily perform better than government planning schemes, because it is not possible for government to gather and process the information that is coded in market signals through alternative means. Hayek is the major theorist here.[9] He developed the epistemology claim as part of an argument that government planning regimes, especially those being developed in socialist countries after World War Two, were doomed to fail. Those schemes sought to replace market mechanisms with a system of administrative decision making. For instance, a government official would decide how many goods a factory should produce and how much it should charge for them, rather than those decisions being dictated by how many of the goods people were willing to buy, and what they were willing to pay for them.

Hayek explained that such schemes were doomed to fail because, without a market, the government officials had no way of knowing how many of the goods should be produced, or whether the resources needed to produce them would be better employed elsewhere. He did this by combining the idea of 'bounded rationality' with Adam Smith's 'invisible hand' thesis. Smith had claimed that deliberate attempts to do good to others often went astray, but the market translates self-interested activities into results that benefit the whole of society by ensuring the efficient allocation of resources. Hayek refers to this tendency of markets to clear at equilibrium as a form of 'spontaneous order'. He goes on:

> Since a spontaneous order results from the individual elements adapting themselves to circumstances which directly affect only some of them, and which in their totality need not be known to anyone, it may extend to circumstances so complex that no mind can comprehend them all.[10]

In the same vein, Jackson says:

> Market exchanges coordinate the decisions of many buyers and sellers within the minimum amount of information being transmitted/communicated between market agents. All the necessary and significant information is embodied in the price signals at which trading takes place. It is not necessary to know the utility function of each consumer or the production function of each producer as in a non-market planning exercise. Nor is it necessary to know the constraints that each faces.[11]

---

9 F Hayek (1973) *Law, Legislation and Liberty*, vol 1, Routledge and Kegan Paul, ch 2; F Hayek (1976) *Law, Legislation and Liberty*, vol 2, Routledge and Kegan Paul, ch 10; see also J Gray (1986) *Hayek on Liberty*, 2nd edn, Basil Blackwell, ch 2.

10 Hayek (1973) p 41.

11 P Jackson (1989) 'The Boundaries of the Public Domain' in W Samuels (ed) *Fundamentals of the Economic Role of Government*, Greenwood Press, pp 106–7.

More prosaically, Hayek says:

> The manufacturer does not produce shoes because he knows that Jones needs them. He produces them because he knows that dozens of traders will buy certain numbers at various prices because they (or rather the retailer they serve) know that thousands of Joneses, whom the manufacturer does not know, want to buy them.[12]

Thus, markets generate and make available for general use information that is diffused amongst all members of society (what their needs are) that cannot be known by central authorities and therefore cannot be centrally planned. This is particularly the case where market participants rely on tacit knowledge such as skill, expertise and internalised norms.[13] Market prices distil, aggregate and communicate millions of individual preferences in a way in which it is not possible for governments to do, even if they could know what individual preferences are (eg by administering surveys).

Although the epistemology claim was originally developed in response to complex and far reaching government planning schemes, its insight has been used to analyse why less grandiose attempts at government decision making also fail. Thus, Wolf argues, as a general principle, that:

> nonmarket [ie government] failures are tied to the absence of nonmarket mechanisms for reconciling calculations made by decision makers of their private and organizational costs and benefits with the costs and benefits of society as a whole.[14]

---

12 Hayek (1976) pp 115–6.

13 Hayek (1973) ch 1.

14 C Wolf (1993) *Markets or Governments: Choosing Between Imperfect Alternatives*, 2nd edn, MIT Press, p 38. Wolf's analysis of government failure is marred by a certain myopia. He recognises that market failure may result in both under- and over-supply of desired goods and services, but he only recognises *over*-supply of government as government failure. Thus, at crucial points, he neglects to consider reasons why governments may *under*-supply goods and services. For example, he rightly argues that the absence of direct market indicators of success leads government agencies to develop *internal* criteria of success (p 68), but he thinks only internal criteria that tend towards increasing government output are likely to be developed. Yet it is clear that such internal criteria can often inhibit as well as encourage government output. For instance, in Australia the organisational culture of the Department of Social Security clearly emphasises 'protecting the public fisc', so that discretions tend to be exercised and doubts resolved against granting benefits. The result is that many qualified applicants are refused benefits. In other words, its goods tend to be *under*-supplied. Similarly, there is ample evidence that regulatory agencies tend to have organisational cultures that stress reluctance to use enforcement powers and tolerance of sometimes flagrant regulatory breaches: P Grabosky and J Braithwaite (1986) *Of Manners Gentle*, Oxford University Press. Wolf's analysis provides no explanation for such phenomenon.

Critique of Liberal Political Economy

Many different criticisms have been made of liberal political economy. The focus here is on those criticisms that specifically relate to the claims for the market outlined above, and in particular the efficiency and epistemology claims. The efficiency claim is to some extent scientific, in that it is empirically testable. Economists have generated an impressive body of empirical data to back it up. However, even if true, the claim proves much less than it appears to. In fact, efficiency is indeterminate as a value in itself. The epistemological claim is less empirically testable than the efficiency claim, but in many ways is more interesting. Like Foucault seems to have been, I am 'intrigued by the properties of liberalism as a form of knowledge calculated to limit power by persuading government of its own incapacity'.[15] Any plausible normative account of political institutions must address the issues raised by the epistemology claim. Again, though, this claim proves much less than it appears to, because of the fundamentally limited and skewed nature of the information processed by markets.

Market failure

The artificiality of the assumptions underpinning the competitive market model means that markets inevitably fail to achieve perfectly efficient outcomes. A long catalogue of market failures has been identified.[16] During the course of the 20th century, the school of welfare economics emerged to investigate market failure and develop forms of government intervention designed to correct them. The discourse of welfare economics has thus provided the justification for a great deal of government intervention in market economies. More recently, welfare economics has been challenged

---

15 C Gordon (1991) 'Government Rationality: An Introduction' in G Burchell et al (eds) *The Foucault Effect: Studies in Governmentality*, Harvester Wheatsheaf, p 47, and see pp 14–17; see also G Burchell (1991) 'Peculiar Interests: Civil Society and Governing "The System of Natural Liberty"' in G Burchell et al (eds) *The Foucault Effect: Studies in Governmentality*, Harvester Wheatsheaf, p 119.

16 These include: externalities (costs associated with producing or consuming a good or service that are not included in its purchase price, and therefore are borne by society generally rather than the producer or consumer); public goods (goods or services that are characterised by broad use, indivisibility and/or non-excludability, so that many or all people benefit from them, and their availability cannot be limited to only those people who are prepared to pay for them); merit goods (goods and services, such as health and education, that primarily benefit individual consumers, but that also have spill-over benefits as well, which means they can be provided by the market, but not at the most socially desirable level); the monopolistic tendencies of free markets (caused by economies of scale), which tend to concentrate production in fewer and fewer hands, decreasing competition; natural monopolies (where provision of a good or service by more than one producer is economically inefficient because of the very high sunk costs involved, such as establishing a water reticulation network); and of course information failures (the inevitable result of human bounded rationality).

by neo-classical economists and public choice theorists, who argue that the cure is often worse than the disease, creating more inefficiency than is avoided.

This debate is not entered into here, for two reasons. First, the questions it raises can only be answered by empirical investigation. Without claiming expertise in this, I think the game is running slightly in favour of the welfare economists. Certainly, the weight of informed opinion on public choice is that it has failed to provide convincing empirical support for many of its key claims.[17] Secondly, and more importantly, the debate does not address the question I am concerned with here: what role is there for political institutions in their own right, rather than as a prop to the market?

The poverty of efficiency

The persuasiveness of the claim that markets are efficient depends on the intuitive attractiveness of efficiency as a value. However, the fact that a particular distribution of resources is 'efficient' does not mean that it is good in any moral sense. Of course, we want to satisfy as many needs as possible, at the lowest possible cost, which is what allocative efficiency seems to promise. The problem is that it does not really promise this at all. In fact, allocative efficiency is quite compatible with a great many glaring, desperate and clearly articulated needs going unsatisfied. As Sunstein points out, a 'distribution in which one person owns everything, and everyone else nothing, is Pareto-optimal; but it would not for that reason be uncontroversial on moral grounds'.[18] As Tresch puts it:

> Unfortunately, Pareto efficiency is too weak to serve as the final arbiter of overall economic well being. It admits an infinity of outcomes, including allocations in which some people enjoy lavish lifestyles while others are mired in poverty.[19]

---

17 While much empirical testing of public choice analysis remains to be done, 'it is not too early ... to reject the profoundly pessimistic implications of the early public choice theories': D Farber, 'Democracy and Disgust: Reflections on Public Choice' (1989) 65 *Chicago-Kent LR* 161, p 162. Many theorists influenced by public choice are now adopting much more moderate positions (see eg M Trebilcock (1994) *The Prospects for Reinventing Government*, CD Howe Institute, pp 31–2, saying that his earlier cynicism was unfounded); and the insights offered by public choice are being seen more as 'tendencies' rather than 'iron laws': see D Farber and P Frickey (1991) *Law and Public Choice*, University of Chicago Press, p 33; and C Sunstein, 'Paradoxes of the Regulatory State' (1990b) 57 *U Chi LR* 407, pp 430–1.

18 C Sunstein (1990a) *After the Rights Revolution: Reconceiving the Regulatory State*, Harvard University Press, p 39.

19 R Tresch (1989) 'Fundamentals Relating to the Economic Functions of Government' in W Samuels (ed) *Fundamentals of the Economic Role of Government*, Greenwood Press, p 188.

Efficiency is thus indeterminate as a value.[20] The fact that a particular distribution of resources is efficient does not mean that it is either good or bad. The 'efficient' outcome of a market process depends entirely on the initial distribution of resources and legal entitlements. If the initial distribution of either is changed, then the efficient outcome is also changed.[21] Thus, before an 'efficient' outcome can be claimed to be a 'good' outcome in any moral sense, it must be demonstrated that the initial distribution was also a morally good one.[22]

Thus, the claim that markets can better meet human needs than political institutions because they can do so more efficiently, and thus more needs are met, may have validity as a quantitative statement, but it is not a qualitative statement. On its own, it is not necessarily a good thing. It is not just a question of how big the pie is; the way the pie is distributed also needs to be considered, and the efficiency claim is totally silent on that question.

Nothing in economics justifies the pursuit of economic efficiency as inherently superior to the pursuit of social justice. Economics can help us to understand how governments can most efficiently achieve their policy goals, but it cannot tell us what those policy goals should be.

> [Economics] is concerned with the relation *between* means and ends rather than the appropriateness of those ends ... [It] examines the consequences of alternative policies or alternative institutional arrangements in the light of policy *ends* that economics itself doesn't specify.[23]

---

20 D Kennedy, 'Cost-Benefit Analysis of Entitlement Problems: A Critique' (1981) 33 *Stan LR* 387.

21 The problem with relying on efficiency as a criterion for judging market processes is exacerbated by the usual substitution of 'Kaldor-Hicks' for Pareto efficiency in policy making processes. Under the Pareto test, the requirement that nobody be left worse off means that those potentially adversely affected by an allocation decision must be compensated, so that they suffer no loss. In practice, this is frequently not possible, so if the criterion was strictly applied then the allocative decision could not be made. The Kaldor-Hicks formulation gets around this by stipulating that a decision is still efficient provided the overall gains to some people outweigh the overall losses to others. Thus, in theory, the winners could compensate the losers, leaving nobody worse off, even though they are not required to. In practice, what this means is that wealth transfers from the poor to the rich are efficient, provided that the rich get richer by more than the poor get poorer, because the rich 'could' compensate the poor for their losses and still be better off, even though they don't.

22 M Kelman, 'On Democracy-Bashing: A Sceptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement' (1988) 74 *Va LR* 199, pp 224–6. Some extremists, such as Nozick, have tried to justify existing distributions as simply the outcome of fair historical processes, but these fairytales are unconvincing: R Nozick (1974) *Anarchy, State and Utopia*, Basic Books.

23 G Brennan (1993) 'Economic Rationalism: What Does Economics Really Say' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin, p 5 (original emphasis).

Unfortunately, many economists and policy makers lose sight of this, and argue in very positive and forceful terms that if a particular policy would produce efficiency gains, then, for that reason alone, it should be implemented.[24]

Critique of the epistemology claim

Markets do provide a framework for utilising dispersed knowledge in a way that political institutions are not able to, but the information processed by markets is profoundly limited and skewed. Markets may know a lot, but they don't know everything, and maybe not even the most important things. Economists claim that markets give people what they most need, by responding to consumer demand. Consumer demand is expressed by people being willing to pay for a good or service. But of course *willingness to pay* is, in part, a function of *ability* to pay. As Frank Stilwell points out:

> The attraction of the market model lies in its apparently democratic character ... This is what the mainstream economists call the 'consumer sovereignty' principle. However, economic inequality is built into the system because it is based on a principle of 'one dollar one vote' rather than 'one person one vote'. This doesn't sound so admirably democratic.[25]

In a market, those with more money will get their needs satisfied more than those with less money. Markets do not care about whose needs are in fact greater, and they do not distinguish between need and greed. In fact, taken seriously, the prohibition on interpersonal comparisons makes that sentence nonsensical, because there is no such thing as greed, only self-defined needs — thus, 'greed is good', or at least morally equal to need. Taken seriously, the prohibition on interpersonal comparisons means that society is not supposed to say that satisfying a rich person's self-defined 'need' for another bottle of champagne is less important than satisfying a poor person's 'need' for food to feed their family.

Unarguably, in Australia today, many glaring and clearly articulated needs go unsatisfied in the marketplace because people are too poor to be able (and therefore willing) to pay for their satisfaction. These glaring and clearly articulated needs are unknowable by the market, because they are expressed in the wrong form. The market cannot process the information. As Lehner and Widmaier put it:

---

24 Eg H Ergas (1993) 'Privatisation and Market Forces: Their Role in Infrastructure Provision' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin, p 158, argues that predicted efficiency improvements make the arguments in favour of introducing user-pays pricing regimes for public transport infrastructure 'compelling', without considering the equity implications of such a change.

25 F Stilwell (1993) 'Economic Rationalism: Sound Foundations for Policy?' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press, p 32.

> the qualities and quantities of goods and services produced and distributed by the market are not directly connected to the needs and preferences of the members of a society, but rather determined by available prices and profits. On an aggregate level, available prices for goods and services depend not only on the aggregate preference structure, but also on the aggregate distribution of income. Consequently, the production and distribution of goods and services resulting from spontaneous market cooperation fits the societal distribution or preferences only to the degree in which the distribution of buying power (wealth and income) corresponds to the distribution of preferences. This correspondence is not guaranteed by the market mechanism.[26]

The information processed by markets about people's needs is not only skewed by their ability to pay, but is also limited because they can't process information about other things at all. For instance, markets can't process information about our non-material needs. It is a pretty impoverished view of human existence that sees shopping as the sum total of our self-realisation. The attempts of some economists to reduce things like love to a willingness-to-pay calculus are not just wrong, but also offensive.[27]

Markets also can only know what current consumers need. Only a current consumer can demand a good. Markets can't possibly know what future generations will need. Some economists claim that markets conserve resources, by providing incentives to save them for future use where their owners calculate that they will be worth more in the future than they are in the present. This would be persuasive if we had perfect knowledge of the future, as the model of perfect competition assumes. However, bounded rationality is a fact, and it places severe limitations on individual abilities to predict the future. Inevitably, the future is discounted. Resource owners tend to prefer certain profits today over uncertain profits tomorrow (especially given that we all have to die sometime).

Markets also only know the value of things to humans, their 'utility'. Markets cannot deal with things that are valuable in themselves, particularly the other life forms with which we share the planet. However many people argue that:

> the elimination of a species ... is objectionable quite apart from its effects on human beings, and indeed for its own sake ... [this] 'deep ecology', does not even refer to human desires. The idea here is that animals, species as such, and perhaps even natural objects warrant respect for their own sake, and quite apart from their interactions with human beings.[28]

---

26 F Lehner and V Widmaier (1983) 'Market Failure and Growth of Government: A Sociological Explanation' in C Taylor (ed) *Why Governments Grow: Measuring Public Sector Size*, Sage, p 242 (footnote omitted).

27 Eg G Becker (1981) *A Treatise on the Family*, Harvard University Press.

28 Sunstein (1990a) pp 68–9.

This comes back to the question that 'the market' is supposed to answer: how do we design human institutions to best satisfy human needs? That's a good question, but it's not the only question that we need an answer to. Another one is: how do we learn again to respect the things with which we share the world, for their *own* sake?

In summary, the market's epistemological strength is also its weakness. Because it is 'unthinking', spontaneous, it escapes some of the limits of human-bounded rationality, but the market is not god, omniscient. The market is just a way of structuring human interactions. It allows us to extend some of the limits of human bounded rationality, but not all of them (whatever convenient assumptions economists make). Further, that extension of rationality, though real, is partial: markets cannot be used to know other things that humans need to know. We need other institutionalisms to deal with these.

Economic rationalism

Despite these limitations to what markets know, the epistemology claim is still a very important insight which can contribute to our understanding of political institutions. The understanding that markets can generate information that political institutions cannot helps explains the influence in recent years of 'economic rationalism' on public policy. Economic rationalism emphasises the market's epistemological 'superiority' over political institutions in allocating resources. While economic rationalism can be used to sharpen public policy analysis and institutional design, it turns into a destructive ideology when it is adopted as:

> a doctrine that says that markets and prices are the *only reliable* means of setting a value on anything, and, further, that markets and money can *always*, at least in principle, deliver better outcomes than states and bureaucracies.[29]

For example, Smith argues that the 'essence of the market solution is that people get what they are actually prepared to pay for'.[30] He argues that governments cannot know how much Australians really value environmentally sensitive areas such as wilderness, because there is no market for them. Therefore, he says, these areas should be sold off to the highest bidder. If Australians really want to conserve them, then they will join together and buy them under the aegis of the Australian Conservation Foundation or similar organisations. Of course, to do so they would have to outbid the timber and mining companies who want to exploit these areas for their resource potential, and who would calculate their bids by reference

---

29 M Pusey (1993) 'Reclaiming the Middle Ground ... From New Right "Economic Rationalism"' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin, p 14 (original emphasis).

30 B Smith (1993) 'Natural Resource Use and Environmental Policy' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin, p 208.

to the strength of market demand for their products. Thus, if those companies outbid the conservationists, that would show that we value environmentally sensitive areas more as manufacturing inputs than we do as protected areas — we would have discovered what we 'really' value.[31]

Smith's argument would be silly if it were not so dangerous. It ignores a number of typical market failures that would occur if his suggestion was followed, such as the many public good aspects of environmental protection, and the problem of imperfect information, including about the areas' ecological importance and future economic potential. More importantly, Smith fails to explain why we should accept the particular 'efficient' allocation of resources that would result from the current wealth distribution, which would clearly favour multinational timber and mining companies over environmentally concerned citizens. Most importantly of all, however, Smith's argument is profoundly undemocratic. Struggling families may well prefer to spend their money on housing, feeding and clothing their children rather than on wilderness protection. However, those families are still entitled to have a view about wilderness protection, and to express it in democratic forums. The days when the right to have an opinion depended on wealth are gone for good. Smith goes so far as to argue that silencing the poor would be a good thing because it would end the current situation where 'every one is deemed to have a legitimate interest in seeking to influence outcomes'![32] Of course, the essence of democracy precisely *is* that everyone has a right to influence outcomes.[33] As an ideology, economic rationalism is profoundly anti-democratic.

Unfortunately, economic rationalism is taken to such ideological extremes all too often. As Stillwell says, rather than an anti-democratic ideology, what is needed is 'a better balance between economic and social concerns which would integrate the pursuit of economic efficiency with a broader range of objectives'.[34] Achieving that difficult task is outside the capabilities of the market, because it requires knowledge of things that markets cannot possibly produce. That is why we have political institutions.

Politics

Assumptions

Political philosophers do not share a set of formalised assumptions in the same way that neo-classical economists do. However, three commonly accepted premises are useful in analysing what political institutions are good for. First, over time, political discourse, and hence the role of political

31 Ibid, p 207.

32 Ibid, p 208.

33 For a more extended discussion, see S Rosewarne (1993) 'Selling the Environment: A Critique of Market Ecology' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press; and R Eckersley (1993) 'Rationalising the Environment: How Much Am I Bid?' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press.

34 Stilwell (1993) p 28.

institutions, is *limitless*.[35] Anything humanely imaginable can be made the subject of political decision. This is not to say that all political decisions are either good or effective, just that they are possible.[36] Also, this is not to say that everything can be the subject of political decision *at once*. The political agenda at any particular time is a 'scarce resource' with its own economy of inclusions and exclusions, of both voices (who gets heard) and issues (what they get heard about).[37]

Secondly, without denying an as yet undetermined role for genetics, our individual identity is, in important ways, the outcome of the social processes through which we develop language, culture, values, beliefs, identifications etc. Participating fully in the processes which make our lives, makes our lives fuller. Political processes are a particularly important part of these social processes, because it is through political processes that we make explicit collective choices about the kind of world that we want to live in. In the end, it is the ability of the state to enforce these collective choices through the exercise of its coercive power that sets it apart from the institutions of civil society, which also play important roles in collective social processes.

Thirdly, state power can legitimately be used to implement majoritarian collective choices, even against the wishes of minorities,[38] subject to procedural and substantive qualifications. The procedural qualification is that the processes of collective decision making must be 'democratic'. In particular, each member of the political community must have a substantively equal right to determine basic political choices (in contrast to the inequality that characterises market participation). The substantive qualification is that there are some things that it is not legitimate for a majority to do, even if the collective decision making process works perfectly. However, and this relates back to the first assumption, the nature of the procedural and substantive limits within which majoritarian democracy is legitimate are both inherently contestable and constantly contested in political discourse.[39]

The role of political institutions

Analytically, the role of political institutions in allocating scarce resources can usefully be separated into three levels (in practice, these processes may be merged or incomplete). At the first level of decision making, political institutions allocate scarce resources to their most highly valued uses, as

35 S Ranson and J Stewart (1994) *Management for the Public Domain*, St Martin's Press, pp 88–91.

36 Although there may be a limit to how many bad decisions a political system can make and survive.

37 A Yeatman (1994) *Postmodern Revisionings of the Political*, Routledge.

38 I assume a pretty general social consensus on this point: even extreme libertarians recognise a minimal coercive 'nightwatchman' role for the state; although this consensus excludes most forms of anarchism.

39 J Nedelsky, 'Reconceiving Rights as Relationship' (1993) 1 *R Const Stud* 67.

defined by a particular set of criteria.[40] In this sense, they are functionally equivalent to a market. Indeed, the criteria used by political institutions to allocate resources often expressly incorporate individual 'need'. However, unlike in a market, in a political institution need cannot only be articulated through willingness to pay. Indeed, in direct contrast to a market, the relevant criterion might be *unwillingness* to pay (because of inability to pay), as in means-tested rent assistance provided by a welfare agency. Of course, political institutions can use other criteria besides need to allocate resources, such as merit, or first come-first serve, or citizenship, or membership of the community (as when a telephone company is obliged to provide basic telephone services to every household in the country irrespective of whether this is economically efficient). Criteria such as ability and availability can be used in distributing social burdens such as military service or jury service.[41]

At the second level of decision making, political institutions decide what criteria should be applied in first level decisions, and what decision making process should be followed. This is a crucial functional difference from markets, which universally operate on only one allocative criterion (willingness to pay), and therefore have neither the reason nor the ability to adopt alternative criteria. Willingness to pay may be a more or less appropriate way to determine where scarce resources are most highly valued, depending on the context. In many contexts, it may well be the best criterion that can be devised. However, manifestly it is not the only possible criterion. Therefore, a process is needed for deciding whether willingness to pay or some other criteria should be used.

> The market provides its own criteria of success, but in the public organisation the criteria must always be sought and once found can never be assumed to be final. It is a condition of the public domain that organisations within it are *criteria-seeking* rather than conditioned by predetermined criteria. The only final criterion is the public interest and this can always be redefined in public discourse.[42]

At the third level of decision making, political institutions assess both their own success, and that of the market, in terms of the public interest criteria established through political processes. In other words, once a level two decision about what criteria and process to use in making a particular sort of allocative decision has been implemented, then the ensuing results can be evaluated. If evaluation shows that the public interest objectives are

---

40 See J Elster (1992) *Local Justice: How Institutions Allocate Scarce Goods and Necessary Burdens*, Cambridge University Press, ch 3, for a 'roughly exhaustive' list of non-market allocative criteria and procedures.

41 Such decisions involve the allocation of the scarce resource of people's time and labour to socially very highly valued uses: criminal justice or defence.

42 Ranson and Stewart (1994) p 97 (original emphasis); see also F Kaufmann (1991a) 'Introduction: Issues and Context' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter, p 19.

not being met, then either the criteria or the process can be changed. In fact, the current intense debate about the proper role of government versus the market is a perfect example of this third level of decision making in action. Again, it is important that markets cannot be used to make such decisions. That is why the debate is a *political* one, and not a purely technical one of economic analysis.

Of course, the ability of political institutions to make decisions at every level is hampered by their imperfect knowledge, and no doubt this is an important part of the explanation for government failure. However, 'leaving it to the market' is not an option. Markets lack the capacity to make either level two or level three decisions, which are both inherently political and fundamentally important. Thus, while there are significant problems with our political decision making processes, we can only try and improve them. That requires improving the ability of political institutions to learn what people need and how to best meet those needs. At present, our understanding of how political institutions learn is limited, having barely moved beyond the negative insight that they cannot know what people want in the same way that markets can.

Government Learning

Hayek was not the only theorist concerned with the implications of bounded rationality for government administration. Many of the important political scientists in the latter part of the 20th century have grappled with the issue as well. Indeed, Herbert Simon is generally credited with first formalising the idea of bounded rationality, but he developed a very different response to the problems of bounded rationality to that developed by market theorists. Like them, he recognises that markets are a type of institution that allows bounded rationality to work: '[t]he market mechanism may provide a way to reach tolerable arrangements in a society even if optimality is beyond reach'.[43] However, he also recognises their limits: '[m]arkets can only be used in conjunction with other methods of social control and decision making; they do not provide an independent mechanism for social choice'.[44] Simon's great contribution was to emphasise and explore the role of institutions generally, and political institutions in particular, in extending the limits of individual cognitive capacities. Lindblom's theories of incrementalism[45] and partisan mutual adjustment[46] similarly explore ways in which public organisations can effectively manage the problems of bounded rationality, without abandoning their tasks to the market. In his incrementalism model, Lindblom is more explicit than Simon about the importance of government learning to rational administration.

43 H Simon (1983) *Reasoning in Human Affairs*, Stanford University Press, p 89.

44 Ibid.

45 C Lindblom, 'The Science of Muddling Through' (1959) 19 *Pub Admin R* 79; C Lindblom, 'Still Muddling, Not Yet Through' (1979) 39 *Pub Admin R* 517.

46 C Lindblom (1965) *The Intelligence of Democracy: Decision Making Through Mutual Adjustment*, Free Press.

However, neither Simon nor Lindblom developed an adequate theory of government learning. Indeed, the ability of governments to learn seems generally to have been taken too much for granted, at least until recently. In considering developing approaches to the issue, it is useful to distinguish level one processes from levels two and three processes.

Level one decision making

For political institutions to successfully allocate scarce resources to meet individual people's needs and wants, they need to know what those needs and wants are. The process by which they learn this is not well understood. For too long, the professional expertise of public officials using their specialised knowledge to identify individual need was assumed to be sufficient: '[t]he good society ... [was] to be *delivered* by knowledgeable specialists, rather than lived and created by the public with the support of professionals'.[47] Legally, procedural fairness might give individual claimants some voice in the process of making decisions about them, but it does not require that any weight be given to their view.

There has been some empirical research into 'client encounters' with public officials.[48] This has focused on the role of street level bureaucrats within government agencies, who have been found often to have significant discretion and autonomy in how they do their job and identified significant power disparities between official and client. More work needs to be done to better understand the relationship between official power and government knowledge.

There are two interrelated aspects here. First, there is an interpretive aspect: we need to know more about the way that officials 'apply their stock of knowledge to the interpretation of instances in order to make these instances intelligible in the light of the organisational life-world within which they work'.[49] Secondly, there is a constructive aspect: we need to know more about the way that people are *changed* by their interactions with public organisations.[50]

Both of these aspects have implications for the extent to which client self-definition should determine how a political institution responds to claims on it. For example, to what extent should a person's assertion of a need determine the outcome of a 'public encounter', if the underlying perception of need was in part *created by* the encounter?[51] More generally,

47 Ranson and Stewart (1994) p 11 (original emphasis); see also G Frug, 'The Ideology of Bureaucracy in American Law' (1984) 97 *Harv LR* 1276, pp 1318–84.

48 M Lipsky (1980) *Street-Level Bureaucracy: Dilemmas of the Individual in Public Services*, Russell Sage Foundation; C Goodsell (1981) *The Public Encounter: Where State and Citizen Meet*, Indiana University Press.

49 D Handelman and E Leyton (1978) *Bureaucracy and World View: Studies in the Logic of Official Interpretation*, Institute of Economic and Social Research, p 15.

50 Lipsky refers to this as the 'social construction' of the client: Lipsky (1980) pp 59–70.

51 This is also true of market interactions.

since public organisations are defined by *public* goals and criteria, an individual's self-definition of need (self-interest) has to be in some way translated into a public interest before it can be organisationally recognised as valid. The developing concept of 'coproduction', which analyses the ways clients do and should participate in the process by which public services are delivered, is one attempt to better understand this process.[52]

Levels two and three decision making

Our understanding of the way that political institutions can and do understand individual needs must address the absence of the self-regulatory mechanisms that operate in market contexts. Political institutions lack a single, clearly defined measure of success equivalent to the 'bottom line' that defines success in the market. Often, their goals and criteria of success are poorly defined, multiple, inconsistent and/or contested. Dissatisfied clients usually cannot 'exit' by transferring their allegiance to a competitor.[53] Failing political institutions usually do not disappear, the way bankruptcy kills off unsuccessful firms in the market. Most of the criteria political institutions use for allocating resources have no way of measuring the intensity of individual preferences the way that, up to a point at least, willingness to pay is able to (the more you want it, the more you will pay for it).

However, Kaufmann emphasises that while the public sector may lack the market's 'comparatively elegant feedback mechanisms',[54] this does not mean that the public sector does not have its own, different feedback mechanisms.

> [T]he fit of guidance, control and evaluation in the public sector is more precarious than in pure market relations, but not impossible. It requires a multiplicity of coordination mechanisms and multiple forms of control.... It is the redundancy of multiple controls which keeps the public sector under control and explains its functioning better than market theory would predict.[55]

---

52 See W Wirth (1991) 'Responding to Citizens' Needs: From Bureaucratic Accountability to Individual Coproduction in the Public Sector' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter, for a discussion and further references. See also N Fraser, 'Women, Welfare and the Politics of Needs Interpretation' (1987) 17 *Thesis Eleven* 88. The concept of coproduction is also relevant to the role of non-government institutions in regulatory policy: P Grabosky, 'Using Non-Governmental Resources to Foster Regulatory Compliance' (1995) 8 *Governance* 527.

53 Although, it has been argued that, in an age of increased geographical mobility, this is one of the benefits of a federal system of government: dissatisfied citizens can move interstate: B Galligan and C Walsh (1992) 'Australian Federalism: Yes or No?' in G Craven (ed) *Australian Federation*, Melbourne University Press.

54 Kaufmann (1991a) p 4.

55 Ibid, p 11.

The link between feedback mechanisms and government learning is an important insight that underpins recent work on organisational learning generally, and government learning in particular.[56] Building on Lindblom's incrementalist approach, this work defines 'learning' as a cyclical, repeated process of identifying mistakes and taking corrective action.[57] It distinguishes between 'single loop learning', where an organisation evaluates whether or not it is meeting its goals, and 'double loop learning', where the organisation evaluates whether or not it has the right goals. This distinction corresponds to the distinction between level two and level three government decision making made above. In the 1994 book *Can Governments Learn?*,[58] it was concluded on the basis of empirical studies that government organisations can learn in both ways, but that the processes through which this occurs are still not well understood. This conclusion is both unsurprising and surprising. It is unsurprising because modern government obviously has not been a total and abject failure — far from it. Common sense tells us therefore that political institutions must have some capacity to learn. What is surprising is how little we know about how they do this in practice.

Can Governments Learn? concentrated on the use of program evaluation methodology as a feedback mechanism. Program evaluation tends to be an internal process, with only an unclear and restricted role for external 'stake-holders' in defining organisational goals and criteria of success. Another important feedback mechanism is the new emphasis in many public institutions on viewing clients as 'customers' and creating avenues for obtaining feedback from them. However, such techniques fail to recognise the importance of the role of 'citizens' as well as 'customers' in shaping political institutions.[59]

> The effect of this reasoning is that the 'consumers' of public goods and services are atomised in relation to each other, and the assumption is made that they can understand and express their preferences independent of any collectively oriented and/or political dialogue about how best to explore, express and meet their needs in relation to publicly provided goods and services. They are no longer members of a public community of citizens, but become instead private, self-interested actors.[60]

---

56 This is often based on Argyris' work: C Argyris and D Schon (1978) *Organizational Learning: A Theory of Action Perspective*, Addison-Wesley; C Argyris (1993) *On Organizational Learning*, Blackwell; C Argyris and D Schon (1996) *On Organizational Learning II: Theory, Method, Practice*, Addison-Wesley. See Ranson and Stewart (1994) ch 8; F Leeuw et al (eds) (1994) *Can Governments Learn?*, Transaction.

57 F Leeuw and R Sonnichsen (1994) 'Introduction: Evaluation and Organisational Learning: International Perspectives' in Leeuw et al (1994) p 3.

58 Leeuw et al (1994).

59 Ranson and Stewart (1994). In this context, 'citizenship' refers to the interest we all share in contributing to level two and level three decisions, in contrast to our interests as customers in level one decisions.

60 A Yeatman (1990) *Bureaucrats, Technocrats, Femocrats: Essays on the*

Harden points out that:

> there is scope for increasing the responsiveness of public services to various forms of expression of consumer demand. However, the 'public' nature of public services means that they must be responsive not only to individuals as consumers, but also to citizens.[61]

Ranson and Stewart argue that the challenge is to develop feedback mechanisms contributing to government learning that operate at the second and third levels of government decision making, not just the first: '[p]roducing a "public" which is able to enter into a dialogue about the needs of the community as a whole is the uniquely demanding challenge facing the public domain'.[62] They describe their model as one of a 'learning society'.

> A learning society is one which strives to place these values and processes of learning at the centre of the public domain, so that the conditions can be established for all to develop their capacities, for institutions to respond openly and imaginatively to a period of change and for the differences between communities to become a source of reflective understanding.[63]

Kaufmann similarly sees a focus on the mechanisms through which political institutions learn as providing the basis of a new model for understanding the public domain

> If we assume that *for effective policy-making it is more important to make learning processes possible than to make the best decision in advance*, we are approaching a new paradigm of political theory. We then have to ask how processes of guidance, of control, and of performance evaluation may be systematically incorporated in policy areas.[64]

In this new model or paradigm, the two key principles for government learning are participation of both the public and affected individuals in defining goals and criteria of political institutions; and a multiplicity of feedback or accountability mechanisms.[65]

Contemporary Australian State, Allen & Unwin, p 2.

61 I Harden (1992) *The Contracting State*, Open University Press, p 6; see also J Stewart and K Walsh, 'Change in the Management of Public Services' (1992) 70 *Pub Admin* 499, p 514.

62 Ranson and Stewart (1994) p 60.

63 Ibid, p 77.

64 F Kaufmann (1991b) 'The Relationship Between Guidance, Control, and Evaluation' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter, p 227 (original emphasis).

65 See also Yeatman (1990) pp 44–58.

Administrative Law and Government Learning

Two key implications for administrative law emerge from this analysis. First, it suggests an alternative way of thinking about the role of administrative law. Secondly, it helps explain why parts of administrative law are being transformed by rapid changes in the techniques of governance.

Administrative law's role

Administrative law's role has traditionally been debated in 'red' versus 'green' light terms.[66] A red-light approach expresses a basic, liberal distrust of government, and emphasises administrative law's role in protecting individuals from it. A green-light approach expresses a basic, democratic trust in government, and emphasises administrative law's role in facilitating it. However, neither blind faith in, nor blind distrust of, government is an adequate basis for developing an adequate theory of administrative law's role. The red versus green light debate is ultimately a futile one.

A government learning perspective provides a fresh starting point. It assumes that government is neither good nor bad, but that it can always learn. Its emphasis on the importance of public participation and the need for a multiplicity of feedback (accountability) mechanisms sits well with the practice of modern administrative law (if not the theory). It's true that, historically, Australian administrative law has concentrated on level one government decision making. Reflecting a red-light orientation, common law justiciability and standing requirements and its procedural fairness implication principle have meant that judicial review, in particular, has applied almost exclusively to individual 'client encounters' rather than to policy making and evaluation. Similarly, merits review mechanisms have tended to be thought of in terms of protecting individual clients. Given that the most important government learning occurs at levels two and three, if that was all there is to administrative law, its contribution to government learning would likely be pretty limited.

However, administrative law is rapidly changing. Judicial review, particularly under the *Administrative Decisions (Judicial Review) Act* 1977 (Cth) (ADJRA), is increasingly concerned with policy making as well as its implementation. Ombudsmen and similar bodies are increasingly concerned with systemic problems. Freedom of information legislation obviously applies to level two and three decision making as well as level one. These changes are both undermining the relevance of simplistic red-light approaches, and increasing administrative law's relevance to government learning models. And in fact, a new understanding of administrative law's role, compatible with current thinking about government learning, is beginning to emerge. Judicial review is increasingly being justified in terms of its development of standards of good primary decision making, rather than in terms of protecting individual plaintiffs.[67] Similarly, the justification

66 See eg Harlow and Rawling's well-known description of the 'red-light' and 'green-light' theories of administrative law: C Harlow and R Rawlings (1986) *Law and Administration*, Weidenfeld and Nicolson, chs 1 and 2.

67 See eg G Taylor (1986) 'May Judicial Review Become a Backwater?' in M

for merits review is increasingly being articulated in terms of its contribution to better primary decision making.[68] Ombudsmen are increasingly developing their role as an aid to the management of public agencies.[69] Freedom of information requirements are explicitly based on a democratic rationale of facilitating public participation and government accountability, the basic building blocks of government learning processes. This is not to say that all elements of administrative law slot easily into a government learning model. However, my contention is that government learning models provide a much sounder for developing our understanding of administrative law's role into the 21st century than what we have at present.

Changing techniques of governance

Large parts of the administrative law that is concerned with establishing and empowering administrative agencies are being transformed by changes in the techniques of governance. These changes include:

- ◊ the commercialisation, corporatisation and partial or full privatisation of government agencies;
- ◊ greater emphasis on competitive contracting and tendering;
- ◊ increased contracting out of government services;
- ◊ increased reliance on incentive based regulation and quasi-markets mechanisms (vouchers, individual transferable fishing quotas, tradeable pollution permits etc); and
- ◊ the use of competition itself as a regulatory mechanism (eg some elements the National Competition Policy reforms).

Taggart (ed) *Judicial Review of Administrative Action in the 1980s: Problems and Prospects*, Oxford University Press, p 177; D Feldman, 'Judicial Review: A Way of Controlling Government?' (1988) 66 *Pub Admin* 21; C Sunstein 'On the Costs and Benefits of Aggressive Judicial Review of Agency Action' (1989) *Duke LJ* 522, p 527; P Bayne, 'The Common Law Basis of Judicial Review' (1993) 67 *ALJ* 781; P Craig (1994) *Administrative Law*, 3rd edn, Sweet and Maxwell, p 382; G Richardson and M Sunkin, 'Judicial Review: Questions of Impact' (1996) *Pub Law* 79; P Cane (1996) *Introduction to Administrative Law*, 3rd edn, Clarendon Press, pp 378–9; and R Creyke et al, 'Success at Court: Does the Client Win' (1998) 87 *Canberra Bull Pub Admin* 134, pp 134–5.

68 Administrative Review Council (1995a) *Better Decisions: Review of Commonwealth Merits Review Tribunals*, Report no 39, Australian Government Publishing Service, p 11.

69 D Pearce, 'The Ombudsman: Neglected Aid to Better Management' (1989) 48 *Aust J Pub Admin* 359; A Cameron (1992) 'Future Directions in Administrative Law: The Ombudsman' in J McMillan (ed) *Administrative Law: Does the Public Benefit?*, Australian Institute of Administrative Law, p 205.

These changes are being driven by a number of reasons, including a desire to deliver government services more efficiently, and an ideological preference for private rather than public activity. One important reason relates to government learning processes. At least sometimes, market-like processes are being used to capture some of the advantages markets have over traditional government decision-making processes. They are being used to make information available to government that more traditional bureaucratic systems cannot generate. For example, Commonwealth fisheries management is shifting from input restrictions to marketable transferable quotas (ITQs) as the key regulative technique, because properly structured market forces can ensure that the industry operates in an environmentally sustainable as well as economically efficient manner. No other instrument of governance can simultaneously deliver both outcomes.[70]

The greater use of market-like processes as techniques of governance is generally, but not inevitably, associated with right-wing politics. Thus, Hirst builds on the ideas of the English guild socialists of the 1920s and '30s to combine participatory institutions and market mechanisms in a theory of 'associative democracy'. A central part of his theory is for government programs, particularly welfare programs, to be delivered through a marketable voucher system.[71] Ayres and Braithwaite draw on both civic republican traditions and economic theory to explore how participatory structures and market-like processes can be combined to improve regulatory programs,[72] an area not addressed by Hirst. Analyses such as these show that participatory structures can complement market-like processes, intensifying their advantages.

Conclusion

Politics and markets each have their strengths and weaknesses. Markets can spontaneously process and make available a huge amount of widely dispersed information in a way that political institutions never can. However they are simultaneously over- and under-inclusive in the type of information they process: over-inclusive in that all demands are responded to, provided they are accompanied by willingness to pay (child pornography is one result); and under-inclusive in that no demand will be responded to unless accompanied by willingness to pay (starving children is one result).

---

70 See Commonwealth of Australia (1989) *New Directions for Commonwealth Fisheries Management in the 1990s: A Government Policy Statement*, Australian Government Printing Service, pp 15–26, for the technical explanation for why this is so. The change from input controls to the market has generated a significant number of judicial review cases: *Austral Fisheries Pty Ltd v Minister for Primary Industries and Energy* (1993) 112 ALR 211; *Australian Fisheries Management Authority v PW Adams Pty Ltd* (1995) 61 FCR 314; and *Bannister Quest Pty Ltd v Australian Fisheries Management Authority* (1997) 77 FCR 503.

71 P Hirst (1994) *Associative Democracy: New Forms of Economic and Social Governance*, Polity Press.

72 I Ayres and J Braithwaite (1992) *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press.

This is an inherent feature of markets; it can't be changed. In contrast, political institutions cannot process the same amount of information, but nor are they tied to information coded in the particular form of ability to pay. We can (within limits) consciously decide what information we want political institutions to process, and design them accordingly.

Politics and markets are not 'equal' or 'complementary'. While the market may be functionally equivalent to level one decision making in political institutions, only political institutions allow decision making to occur at levels two and three. And whereas political institutions can identify and at least to some extent correct market failures, markets cannot reciprocate. Only political institutions can their political failures, even if the means to that end is to the deliberate use of a market or market-like mechanism instead of a more familiar governmental mechanism.

Political institutions must be learning institutions. Learning is not 'built in' to them, the way that it is in market processes, but is a question of institutional design. Administrative law is part of that institutional design. Its mechanisms for participation and accountability are part of the wider mechanisms of participation and accountability that the government learning literature identifies as being at the heart of government learning processes. The greater use of market-like processes can be another mechanism of government learning, opening up new feedback mechanisms and increasing the information available to government. However, they are inadequate feedback mechanisms on their own, just as structures of representative and responsible government are inadequate on their own. The danger is that many existing administrative law mechanisms will be closed down, on the assumption that they can be replaced by market processes.[73] However, making government learn better requires *increasing* the amount of feedback to government, not simply replacing one partial mechanism with another. A clear challenge for administrative lawyers in the 21st century will be to ensure that administrative law's traditional values of participation and accountability remain part of new, market-like techniques of governance.

> Far from being cause for diminishing the role of administrative lawyers, the shift in favour of incentive-orientated instruments poses a host of new challenges for those concerned with the administrative state. Incentive-oriented instruments in many cases call for new forms

73 See eg Administrative Review Council (1995b) *Government Business Enterprises and Commonwealth Administrative Law*, Report no. 38, Australian Government Publishing Service, p 40; Australian Law Reform Commission and Administrative Review Council (1995) *Open Government: A Review of the Federal Freedom of Information Act 1982*, Australian Government Publishing Service, p 213, arguing that Commonwealth government business enterprises should be exempt from administrative law requirements in respect of their competitive commercial activities because competitive forces will perform the same function. It is clear, however, that market forces produce a different kind of institutional learning from that produced by administrative law requirements. It cannot be assumed that the two kinds of learning are functionally equivalient.

of regulation, not the absence of regulation. The issue for administrative lawyers is how we can promote and preserve important values associated with the administrative state in the face of this shift in instrument choice. There is an urgent need to reflect values such as democratic participation and distributive justice in the design of incentive-oriented instruments.[74]

References

Books, Articles and Reports

Administrative Review Council (1995a) *Better Decisions – Review of Commonwealth Merits Review Tribunals*, Report no 39, Australian Government Publishing Service.

Administrative Review Council (1995b) *Government Business Enterprises and Commonwealth Administrative Law*, Report no. 38, Australian Government Publishing Service.

Argyris, C (1993) *On Organizational Learning*, Blackwell.

Argyris, C and D Schon (1978) *Organizational Learning: A Theory of Action Perspective*, Addison-Wesley.

Argyris, C and D Schon (1996) *On Organizational Learning II: Theory, Method, Practice*, Addison-Wesley.

Australian Law Reform Commission and Administrative Review Council (1995) *Open Government: A Review of the Federal Freedom of Information Act 1982*, Australian Government Publishing Service.

Ayres, I and J Braithwaite (1992) *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press.

Bayne, P, 'The Common Law Basis of Judicial Review' (1993) 67 *ALJ* 781.

Becker, G (1981) *A Treatise on the Family*, Harvard University Press.

Brennan, G (1993) 'Economic Rationalism: What Does Economics Really Say' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin.

Burchell, G (1991) 'Peculiar Interests: Civil Society and Governing "The System of Natural Liberty"' in G Burchell et al (eds) *The Foucault Effect: Studies in Governmentality*, Harvester Wheatsheaf.

Cameron, A (1992) 'Future Directions in Administrative Law: The Ombudsman' in J McMillan (ed) *Administrative Law: Does the Public Benefit?*, Australian Institute of Administrative Law.

Cane, P (1996) *Introduction to Administrative Law*, 3rd edn, Clarendon Press.

Commonwealth of Australia (1989) *New Directions for Commonwealth Fisheries Management in the 1990s: A Government Policy Statement*, Australian Government Publishing Service.

Craig, P (1994) *Administrative Law*, 3rd edn, Sweet and Maxwell.

Creyke, R et al, 'Success at Court: Does the Client Win' (1998) 87 *Canberra Bull Pub Admin* 134.

Eckersley, R (1993) 'Rationalising the Environment: How Much Am I Bid?' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press.

74 R Howse et al, 'Smaller or Smarter Government?' (1990) 40 *U Toronto LJ* 498, p 499.

Elster, J (1992) *Local Justice: How Institutions Allocate Scarce Goods and Necessary Burdens*, Cambridge University Press.
Ergas, H (1993) 'Privatisation and Market Forces: Their Role in Infrastructure Provision' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin.
Farber, D, 'Democracy and Disgust: Reflections on Public Choice' (1989) 65 *Chicago-Kent LR* 161.
Farber, D and P Frickey (1991) *Law and Public Choice*, University of Chicago Press.
Feldman, D, 'Judicial Review: A Way of Controlling Government?' (1988) 66 *Pub Admin* 21.
Fraser, N, 'Women, Welfare and the Politics of Needs Interpretation' (1987) 17 *Thesis Eleven* 88.
Frug, G, 'The Ideology of Bureaucracy in American Law' (1984) 97 *Harv LR* 1276.
Galligan, B and C Walsh (1992) 'Australian Federalism: Yes or No?' in G Craven (ed) *Australian Federation*, Melbourne University Press.
Goodsell, C (1981) *The Public Encounter: Where State and Citizen Meet*, Indiana University Press.
Gordon, C (1991) 'Government Rationality: An Introduction' in G Burchell et al (eds) *The Foucault Effect: Studies in Governmentality*, Harvester Wheatsheaf.
Grabosky, P, 'Using Non-Governmental Resources to Foster Regulatory Compliance' (1995) 8 *Governance* 527.
Grabosky, P and J Braithwaite (1986) *Of Manners Gentle*, Oxford University Press.
Gray, J (1986) *Hayek on Liberty*, 2nd edn, Basil Blackwell.
Handelman, D and E Leyton (1978) *Bureaucracy and World View: Studies in the Logic of Official Interpretation*, Institute of Economic and Social Research.
Harden, I (1992) *The Contracting State*, Open University Press.
Harlow, C and R Rawlings (1986) *Law and Administration*, Weidenfeld & Nicolson.
Hayek, F (1973) *Law, Legislation and Liberty*, vol 1, Routledge & Kegan Paul.
Hayek, F (1976) *Law, Legislation and Liberty*, vol 2, Routledge & Kegan Paul.
Hirst, P (1994) *Associative Democracy: New Forms of Economic and Social Governance*, Polity Press.
Howse, R et al, 'Smaller or Smarter Government?' (1990) 40 *U Toronto LJ* 498.
Jackson, P (1989) 'The Boundaries of the Public Domain' in W Samuels (ed) *Fundamentals of the Economic Role of Government*, Greenwood Press.
Kaufmann, F (1991a) 'Introduction: Issues and Context' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter.
Kaufmann, F (1991b) 'The Relationship Between Guidance, Control, and Evaluation' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter.
Kelman, M, 'On Democracy-Bashing: A Sceptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement' (1988) 74 *Va LR* 199.
Kennedy, D, 'Cost-Benefit Analysis of Entitlement Problems: A Critique' (1981) 33 *Stan LR* 387.
Leeuw, F and R Sonnichsen (1994) 'Introduction: Evaluation and Organisational Learning: International Perspectives' in F Leeuw et al (eds) *Can Governments Learn?*, Transaction.
Leeuw, F et al (eds) (1994) *Can Governments Learn?*, Transaction.
Lehner, F and V Widmaier (1983) 'Market Failure and Growth of Government: A Sociological Explanation' in C Taylor (ed) *Why Governments Grow: Measuring Public Sector Size*, Sage.
Lindblom, C, 'The Science of Muddling Through' (1959) 19 *Pub Admin R* 79.

Lindblom, C (1965) *The Intelligence of Democracy: Decision Making Through Mutual Adjustment*, Free Press.

Lindblom, C, 'Still Muddling, Not Yet Through' (1979) 39 *Pub Admin R* 517.

Lipsky, M (1980) *Street-Level Bureaucracy: Dilemmas of the Individual in Public Services*, Russell Sage Foundation.

Nedelsky, J, 'Reconceiving Rights as Relationship' (1993) 1 *R Const Stud* 67.

Nozick, R (1974) *Anarchy, State and Utopia*, Basic Books.

Pearce, D, 'The Ombudsman: Neglected Aid to Better Management' (1989) 48 *Aust J Pub Admin* 359.

Pusey, M (1993) 'Reclaiming the Middle Ground ... From New Right "Economic Rationalism"' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin.

Ranson, S and J Stewart (1994) *Management for the Public Domain*, St Martin's Press.

Richardson, G and M Sunkin, 'Judicial Review: Questions of Impact' (1996) *Pub Law* 79.

Rosewarne, S (1993) 'Selling the Environment: A Critique of Market Ecology' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press.

Simon, H (1983) *Reasoning in Human Affairs*, Stanford University Press.

Smith, B (1993) 'Natural Resource Use and Environmental Policy' in S King and P Lloyd (eds) *Economic Rationalism: Dead End or Way Forward*, Allen & Unwin.

Stewart, H, 'A Critique of Instrumental Reason in Economics' (1995) 11 *Econ & Phil* 57.

Stewart, J and K Walsh, 'Change in the Management of Public Services' (1992) 70 *Pub Admin* 499.

Stilwell, F (1993) 'Economic Rationalism: Sound Foundations for Policy?' in S Rees et al (eds) *Beyond the Market: Alternatives to Economic Rationalism*, Pluto Press.

Sunstein, C, 'On the Costs and Benefits of Aggressive Judicial Review of Agency Action' (1989) *Duke LJ* 522.

Sunstein, C (1990a) *After the Rights Revolution: Reconceiving the Regulatory State*, Harvard University Press.

Sunstein, C, 'Paradoxes of the Regulatory State' (1990b) 57 *U Chi LR* 407.

Taylor, C (1986) 'May Judicial Review Become a Backwater?' in M Taggart (ed) *Judicial Review of Administrative Action in the 1980s: Problems and Prospects*, Oxford University Press.

Trebilcock, M (1994) *The Prospects for Reinventing Government*, CD Howe Institute.

Tresch, R (1989) 'Fundamentals Relating to the Economic Functions of Government' in W Samuels (ed) *Fundamentals of the Economic Role of Government*, Greenwood Press.

Wirth, W (1991) 'Responding to Citizens' Needs: from Bureaucratic Accountability to Individual Coproduction in the Public Sector' in F Kaufmann (ed) *The Public Sector: Challenge for Coordination and Learning*, de Gruyter.

Wolf, C (1993) *Markets or Governments: Choosing Between Imperfect Alternatives*, 2nd edn, MIT Press.

Yeatman, A (1990) *Bureaucrats, Technocrats, Femocrats: Essays on the Contemporary Australian State*, Allen & Unwin.

Yeatman, A (1994) *Postmodern Revisionings of the Political*, Routledge.

Cases

Austral Fisheries Pty Ltd v Minister for Primary Industries and Energy (1993) 112 ALR 211.

Administrative Decisions (Judicial Review) Act 1977 (Cth).

Australian Fisheries Management Authority v PW Adams Pty Ltd (1995) 61 FCR 314.

Bannister Quest Pty Ltd v Australian Fisheries Management Authority (1997) 77 FCR 503.