Bureaucracy and Representative Government.

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can lead to greater flexibility and higher productivity" (p. 142).

The second empirical study in the Dunning volume is by M. Whitehead and concerns the formation of the multinational company Agfa-Gevaert. This case study provides many useful insights into the causes of the merger between the German and Belgian film manufacturer, the mechanics, costs and benefits of merger, and the effects of world-wide competition in the photography industry. The financial results of the merger were still under study at the time the paper was written.

The studies by Franko, Steuer and Gennard and Whitehead are important contributions to our stock of empirical knowledge about multinational corporations. They are worthy of imitation.

The remaining papers in the Dunning volume present variations on major, well-known themes with differing degrees of originality in the presentation of standard arguments. Dunning, in the introductory chapter, competently surveys the broad field of study of multinational enterprises. K. Pavitt reviews knowledge on the transfer of technology through multinational firms. His OECD data provide a limited and disappointing amount of information and I am looking forward to seeing more results from work done with these data in the future. The papers by D. Lea on trade unions and multinational companies, by D. Robertson and J. F. Sudworth on balance of payments effects, also competently cover much familiar material.

I found the well articulated paper by E. Penrose and P. Streeten on direct foreign investment and the less developed countries to be enjoyable reading. Like J. Behrman's paper and G. Curzon's forceful comment on governments and the multinational firms, these papers brought out well the issues of equity, efficiency, nationalism and sovereignty, which underly the wide-spread public interest in the topics. The universal conclusion of papers of this sort seems to be the call for cost-benefit analysis, and the papers in this volume are no exception.

R. Murray's paper on "The Internationalization of Capital and the Nation State" suggests that nation states and multinational enterprises may be complementary rather than rivals in many important social functions. He develops a tedious analytical framework to make this point. R. Aliber concludes that the existence of different currencies in the world provides the main motive for the existence of multinational firms. The theoretical arguments on which this conclusion rests are correct, but the excessive importance attached to this factor is rightly criticized by Dunning in his comment on Aliber's paper.

I recommend both books as supplementary reading in courses in international economics at the graduate level. Several of the papers in the Dunning book, especially those by Penrose, Streeten, Behrman, Curzon and Whitehead, are suitable for undergraduate courses and should be of interest to non-economists.

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500 Administration; Business Finance; Marketing; Accounting

510 ADMINISTRATION

Bureaucracy and representative government. By WILLIAM A. NISKANEN, JR. Chicago: Aldine-Atherton, 1971. Pp. x, 241. $7.75.

This book is a lively, well organized, clearly written development of a model of bureaucratic production. Its use of elementary price theory and democracy theory is far more extensive than any other work on bureaucracy, and the model's implications are repeatedly subjected to empirical tests. I recommend it as "suggested reading" for graduate courses in public finance. The author, an ex-bureaucrat, has strong beliefs regarding the state of our federal bureaucracy. He combines these beliefs with his theory of bureaucratic production and a model of representative government to claim that our current bureaucracy substantially overproduces its outputs and the poorest ⅗ of the American population gets a negative aggregate surplus out of our federal government.

Despite all of the book's good qualities, it did not budge any of this reviewer's *a priori* beliefs. This situation is due to some glaring mistakes in price theory together with some obviously arbitrary, but critical, observational judgements. To elaborate, I will outline and criticize the basic argument of the book.

Niskanan deals first with an abstract bureaucracy, be it a government organization or a grant-financed non-profit institution. To begin the argument, he assumes that the bureaucrats care about wages and the bureau's output and that the bureaucrats cannot receive more than their (rising) supply price. From this, it allegedly follows that bureaucrats, given a choice of an output, would pick an output that maximizes the budget. This, of course, implicitly rules out bureaucrats who supply inferior factors, factors whose demand would decline with output. But, more importantly, the rational bureaucrat in such a model cares about the bureau's total output rather than its budget size for he is constrained to remain on his rising supply curve. Correcting this slip greatly simplifies Niskanan's argument by removing a possible solution where the marginal social value of the bureau's output is zero. The heart of the theory is then that the bureau is assumed to choose a maximal output given that it somehow receives all-or-nothing demand prices subject only to the constraint that revenues cover competitively determined costs. This immediately implies output solutions at which average prices equal average costs so that—assuming decreasing MRSs and nondecreasing marginal costs, which Niskanan implicitly does—there is overproduction of the bureau's output.

The bureau's ability to freely choose its outputs and receive all-or-nothing prices is assumed by Niskanan to come basically from the superior bargaining ability of the bureaucrats over the bureau's trustees, who represent the customers. The choice of output always goes to the bureau allegedly because of the high elasticity of its supply curve relative to the demand curve of the trustees and the technical information superiority of the bureaucrats. But relative elasticities of demand and technical information superiority have nothing whatever to do with who gets to choose the output and price in a transaction, all that these factors determine are the price limits in the bargaining relation. What does determine who chooses the output and price in a bilaterial monopoly is the relative returns and costs of making bargaining commitments. Since a group of trustees generally deals with many bureaus and a bureau deals with only one group of trustees, the returns to making commitments are higher to a group of trustees than to a bureaucrat. Furthermore, a commitment of a single bureaucrat, the bureau chief, to withhold output is essentially meaningless because he controls no resources vital to the production of the bureau—he will simply be replaced if he refuses to produce the output that the trustees want at any price they set which is not below the supply price. In any case, in the real world it is obvious that the trustees—not the bureaucrats—decide on the final budget of the bureaus.

What Niskanan's argument requires is that the bureaucrats be able to misrepresent their costs at outputs *other than their desired output* to the extent that the trustees are induced to choose the output that the bureaucrats want to produce. But such misrepresentation is simply implausible. It implies that: a) For outputs below that desired by the bureaucrats, trustee-expected average costs *fall* with output (at a rate faster than benefits) even though actual costs do not (decreasing actual costs would permit bureaucratic *undersupply* in Niskanan's model, a fact which Niskanan fails to note); and b) For outputs above the desired output of the bureaucrats, trustee-expected average costs *rise* relative to benefits. The suspicious trustees with no cost data at all would significantly improve the benefits of their constituents by merely computing the average cost at the bureau-recommended output and assuming constant costs of production in making their budget allocation to the bureau. Furthermore, the logic of the argument that keeps wages down to reservation prices, that there is competition for jobs within a bureau, applies to the bureau chiefs too. Any striving underling who knows what's going on can surely raise his wage by informing the trustees of the true costs or promising to deliver lower outputs at the true costs. Under these conditions, the purchaser of the bureau's output becomes a monopsonist and underproduction rather than overproduction of the output of the bureau would result so long as some of the bureau's inputs are nonspecific to the bureau.

Finally, in Chapter 14 of the book, Niskanan begins to develop an entirely different, much more realistic, model of government output determination—one in which "review commit-

tees" (certain proper subsets of elected representatives) discover the costs of production and decide on a generally different output than that chosen by the bureau. The two, generally inconsistent, models of output determination are never resolved in the book, although Niskanan conjectures that the actual output is somewhere in between the review committee's and the bureau's optimal outputs. Governmental overproduction always occurs in the new model, but only because Niskanan assumes that review committees are always weighted in favor of legislative representatives who have relatively high demands for the outputs they are reviewing. This assumption is not empirically obvious and it is difficult to believe that the legislature would consistently set up review committees whose advice they should ignore (because they are systematically biased toward recommending outputs larger than the median legislator would desire). Perhaps sensing this, Niskanan calculates that the U.S. legislature itself is weighted in favor of the high demand groups because low per capita income groups are concentrated in larger states, which dilutes their per capita voting power in the Senate. But this dilution of votes of the poor is not sufficient for governmental overproduction. The argument also requires that simple transfer payments be ruled out and that higher per capita income groups favor larger government expenditures because the benefits of government expenditures rise with income faster than do taxes. Niskanan explicitly makes these assumptions, but they make his overproduction result, along with his result that the poorest ⅘ of the population obtains a negative aggregate benefit from the government, completely arbitrary. One could justify underproduction by making equally plausible, alternative assumptions.

So there is little reason in this book to change our subjective probability of governmental overproduction. We already knew that bureaus want tremendously high outputs to increase their factor rents, but that the governmental representatives, who are aware of the desires of the bureaucrats and are disciplined by political forces involving majority rule voting, keep these desires in check, while existing voting models do not give us much of a hint as to whether the outputs determined by the government representatives are too large or too small.

Niskanan's main policy suggestion is reasonable and conventional despite the fact that his model is empirically unreasonable. This policy implication is to allow several bureaus to produce the same kind of output and compete for government business. His argument for this policy is that competition among bureaus leads them to produce a Pareto optimal output by generating a solution in which a constant-per-unit price equals average cost. But this is, of course, an error in elementary price theory. Optimal outputs occur where price equals marginal cost. His repeated arguments for the optimality of competition between bureaus (and cities and non-profit organizations) are simply incorrect. Nevertheless, competition between bureaus does appear, in the real world, to reduce the costs of review committees and the legislature, which make the actual budget decisions, of estimating the actual costs for any total output. It seems natural to suppose that legislators make socially more efficient decisions when they possess more accurate cost information. However, recommending competition among bureaus must be made in the realization that dealing with several bureaus for one output increases the overhead costs of transacting, *i.e.*, sacrifices an economy of scale.

While Niskanan points out that several implications of his model are verified by experience, more plausible, *ad hoc* explanations for these implications exist and should readily occur to the reader. Furthermore, Niskanan fails to point out some implications which cast much doubt upon the theory. His theory implies, for example, that 1) managers of large, private companies should prefer that their companies be nationalized so that they could become government bureaucrats, 2) wealthy people want higher government spending and taxes and 3) the median voter class—the only class that can swing elections—gets no surplus from the existence of a government and would just as soon not have *any* government expenditures even though this would mean foreign takeover and enslavement of some form.

The book contains generalizations of the simple model to cases in which a) bureaus obtain some revenue from per-unit sales and b) there

are several time periods. In the former case, Niskanan assumes that the demand of the trustees is independent of the demands of the non-trustee customers, while the initial formulation of the problem dictates that the fixed contributions of the trustees are reduced by the sales of the output to non-trustees. So the simple model also should apply to bureaus that obtain some revenue from non-trustee sources. Our post offices too should generate such speedy delivery systems that there is no social surplus (to the median voter) from U.S. postal services according to the logic of Niskanan's theory. Once again, simple introspection weighs heavily against the theory. In the case of several periods, Niskanan considers only a case in which a bureau has a chance of producing a given set of outputs over time at lower current costs and higher future costs of, say, the same magnitude. The rational bureaucrat who will not be working in the subsequent period will not take this economical opportunity because it lowers his current budget. But this decision is a decision on a capital good output and, according to Niskanan's theory, should be reviewed as such and therefore, as above, determined by the elected representatives, not the bureaucrats. Still, there is a ring of truth to the argument, which is based on the fact that review committees cannot measure and evaluate all of the outputs of the bureau. In this reviewer's opinion, this difficulty of measuring and evaluating performance should be at the center of any argument contrasting public and private institutions; it should not be merely implicit in an incorrectly specified example.

The basic goal of this book was to contrast the behavior of governmental with private organizations. The difference, of course, lies in the differential incentives of the organization leaders. These differences can be derived from the definition of governmental institutions. What makes an organization "governmental" rather than "private" is the fact that the organization is not economically responsible for some specified set of real losses it imposes on others or cannot sue to capture some specified set of gains it confers upon others [1, Thompson]. Government institutions are more efficient than private institutions if and only if the economies of irresponsibility exceed the costs. The economies of irresponsibility are the savings in the costs of measuring and evaluating the effect one has on the benefits of others while the costs are the well-documented disincentive effects which occur when an individual does not receive his product. A corporation president has every aspect of his performance evaluated every day in the stock market by hundreds of profit calculators. A bureau chief has a small set of his socially relevant performance evaluated about once a year by a few busy individuals. So the typical bureau chief makes hundreds of decisions each year that significantly affect the aggregate benefits of others that will never be made the basis for payments or charges to him. Therein lies the benefits, costs, and peculiarities of bureaucracy and government activity. What an economist can profitably contribute to improving governmental efficiency are incentive systems which will induce more efficient behavior from our bureaucrats without requiring markets or elections. Pleas to convert bureaus to competitive suppliers, while possibly wise, seem to miss the whole point of governmental supply.

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REFERENCE

1. THOMPSON, E. A. Book reviews of *Public investment, the rate of return, and optimal fiscal policy* by K. Arrow and M. Kurz, *Econometrica.*

700 Agriculture: Natural Resources

710 AGRICULTURE

The collective farm in Soviet agriculture. By ROBERT C. STUART. Toronto, London, and Lexington, Mass.: D. C. Heath, 1972. Pp. xx, 254. $12.50.

This book studies collective farm management during the 1950s and early 1960s. Much of the material is from the author's dissertation on collective farm management, and the substance of two chapters has appeared in *Soviet Studies* [2, 1971] and in *The Soviet rural community* [1, 1971, pp. 121–38]. Individuals who fill collective farm management positions are described comprehensively: their personal