

ASYMMETRIC INFORMATION IN NEW PUBLIC MANAGEMENT

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Abstract

Reforming process in public administration can be based on principles of New Public Management that seeks for higher efficiency by applying business-like methods in public administration. It deals with the contracting out practice, when public goods and services are delivered by private economic units. Private delivery of public goods and services is often assumed to be more efficient and economic on one hand, but on the other hand, it may also be connected with worse quality, and availability of them, and can be accompanied by asymmetric information linked to moral hazard and adverse selection. Disaggregation of public sector can lead to increasing numbers of units providing public activities, and so principal-agent model can be applied.

The principles of New Public Management, private delivery of public goods and services and the presence of asymmetric information in it are discussed in the paper, with some applications on the Czech Republic.

Key words: new public management, asymmetric information, contracting out, corruption

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Introduction

The need of having more efficient public administration can be identified in majority of countries within the EU members. Even the whole EU administration calls for such tendency. Another claim is to base public administration on ethics in major extent. The process of public administration reforms is driven by social, economic, political and technological factors, not only on national, but increasingly also on international, or global, level. The combination of those factors on one hand, and of the crisis of social state on the other makes the reform be necessary, and emphasizes the performance, efficient spending of public money, and increasing social welfare.

One way how to obtain those objectives can be to delegate providing some government activities to private sector or other external providers. Private sector is assumed to be more economical, efficient and cost saving than public sector and the government may want to change the way of providing public goods and services so as it were more similar to private business in its positive characteristics. In practice there are many examples of positive consequences of such delegation, but on the other hand there are also many examples of excessive wasting public sources. Because the result is not always positive, it is necessary to look for such mechanisms and methods that will lead to optimum gains and minimum shortcomings.

1 New Public Management – a new way of public administration

New public management (NPM) is in common sense the government policy that seeks for more efficient, modern public sector combining democracy and the market economy. It was applied since 1980s as the idea based on the assumption that using private sector management methods can lead to higher efficiency avoiding side-effects linked with market-like activities. NPM is based on disaggregation (organizations on many levels can participate on providing public goods and services), competition (leading to more rational choice of activities) and motivation by incentives (better than direct management). Besides that the role of the state is changing, not only because of decreasing social role of the state, but also because of the lack of budget finance, of increasing complexity of social life, new technologies, and the need of people for good governance methods.

Dunleavy (1991) says NPM is based on criticism of bureaucracy as the organizing principle in public administration. He characterizes public administration based on bureaucracy as inflexible system coming from complex hierarchical rules, top-down decision-making processes, moving far and far from citizens' expectations. NPM in 1980s was based on the assumption that private sector and its management is more rational and efficient than public sector and public administration. While government remained "rigid and bureaucratic, expensive, and inefficient" (Pierre & Petters, 2000, p. 5), the private sector had to change radically, because of increasing competition on international level, global trends, innovations, environmental limitations and political factors.

In 1990s NPM movement was based on the need to apply techniques and methods of business, to go away from anonymous bureaucratic processes towards active management and visible managers with clear responsibility, and then accountability (Hood, 1995, pp. 96-97).

1.1 Theoretical background of New Public Management

Hood (1991, p. 5) says NPM represents “a marriage of two different streams of ideas.” The first source is new institutional economics built on public choice theory, principal – agent theory, and transactional costs theory. The second is managerialism with its contract theory, management by objectives. Hood (1991, p. 6) links those two sources in two sides of managerial system of public administration: “making managers manage”, and “letting managers manage”. Hood (1991, pp. 4-5; 1995, p. 96) also gives basic principles of NPM: emphasis on professional management (freedom to manage), explicit standards and measures of performance, a shift from bureaucratic procedures to output controls rules, from unified system of administration to disaggregation and decentralization, higher competition within public sector leading to decreasing costs and increasing standards through contracts, focus on private sector-like management practices, cost cutting, and efficiency.

1.2 Criticism of New public Management

The theory and practice of NPM was criticized in many ways. Schick (1996, pp. 25-26) says NPM ignores the core difference between private and public management, it narrows the responsibility of public sector, weakens common values and interests. Metcalfe (1999) assumes that the important feature of the government is organizational diversity given by complexity of government tasks, so it is impossible to exploit general theses of performance – public management should react more flexibly to different criteria of effectiveness – it must do also activities that do not bring profit (health care of low income patients, small schools, social programs for the poor). Schick (1996, pp. 25-26) criticizes NPM for eroding traditionally respected values and ethics of civil servants (such as fairness, equality, probity, loyalty, and impartiality).

All this comes from the fact that NPM is based on output controls and discretionary management as imitation of private management more than on systems based on requirements of open procedures and processes. NPM has the only guarantee of outcome – ethical norms of an individual’s behavior. In spite decreasing values and ethical norms measuring and monitoring is very difficult, it must represent public concern (general ethics) that should be the subject of government intervention.

NPM is criticized for low interest in democratic forms. Metcalfe (1999) criticizes NPM for paying low attention to inhabitants’ involvement and looks on public services

receivers only as clients or customers, and not as members of democratic states (who, more of that, finance all those activities from their taxes).

NPM is the subject of criticism because it is assumed to serve to career interests of elite group of bureaucrats more than the mass of low-level civil servants (Hood, 1991, p. 9).

NPM is also criticized for focusing on managerial reforms, the aim of which is to reach efficiency and economy within limitations given by policy and sources, on the account of political issues, it means, NPM stresses individual results of managerial reforms, and not contribution to overall strategic purpose. Metcalfe (1999) says NPM makes a gap between policy implementation and policy making.

1.3 Valuating New Public Management

NPM can be successful in improving efficiency. But it is not the best solution of current problems in public sector. It can involve further problems, and can have a negative impact on such fields of activities as health care, social welfare, education etc. because orientation on cost reduction and efficiency can lead to decreasing quality and availability of such public services, reducing cooperation among parties involved, decreasing morale of civil service – this can lead to increasing general suspicion to government and civil service. Public policy is justified by market success, and this can lead to decreasing accountability. The space for politics and government narrows, overall democratic control weakens. Basic principles of NPM got exhausted in countries where it was applied first (UK, USA, Australia, New Zealand, Canada, the Netherlands, Japan).

The process of public administration reform based on NPM was criticized, and so it was followed by other theories of public administration, connected especially with digitalization, holistic view on the world given by such processes as globalization, digitalization, and at the end of 2010s by financial and than wider economic crisis covering whole world. Since the beginning of the 21st century new approaches to public administration aroused like Third Way thinking (Giddens, 1998), Public Value Theory (Moore, 1995; O'Flynn, 2007) or New Public Service (Denhardt & Denhardt, 2000), and Digital Era Government (Dunleavy & Margetts, 2006).

The main criticism of NPM is oriented to the potential possibility of corruptive behavior that is often connected with business activities and can move to public administration through splitting large bureaucracy into many smaller agents providing public goods and services, competing one with another and seeking for maximizing their own utility,

creating flexible networks that make more difficult to maintain accountability and oversight. Another, even more important source of potential corruptive behavior is the fact that the line between the government and private actors becomes more and more blurred.

Corruption is not only simply a moral concern or a matter of principle. It has a very negative impact on government performance, and well being of individuals without money and power. World Bank says corruption is a single greatest obstacle to economic and social development. Citizens become cynical to government when they feel government does not work on their behalf. It can have strong economic impact – citizens are less willing to pay taxes or develop their economic activity.

Although NPM can be taken as a controversial concept thanks to above mentioned consequences, it can also be inspiring for Czech policy-makers because of its positive elements. Besides that this concept provides the space for analyzing behavior of economic units through the process of contracting out including the problem of asymmetric information.

NPM does not replace traditional framework of public administration, but adds a new approach to it – contractualism. So in NPM the government manages public sector by a set of contracts. NPM can be very beneficial, but it can also have some limitations, so it cannot be able to solve all the problems of public sector. But if carefully selected and adequately applied, some elements of NPM can be very useful for more efficient public sector.

2 Asymmetric information in public administration

Public administration reform process is to lead to higher efficiency in spending public money and providing public goods and services. The decentralization and deconcentration of government activities means that there come into existence many structures, economic units, internal markets, non-governmental organizations and political networks which differ one from another in their position, objectives, the subject of activity, organizational forms, methods, procedures and money demanding processes. The more of those elements are the more intensive the problem of information asymmetry can be. Besides that, it is more difficult to administer such complex of elements and activities¹.

Looking for a model of performance that can be applied on such diversity of units and activities, there is the only possibility: principal – agent model.

¹ There can be another case of information asymmetry – when the government conceals information about its activities – this is not the subject of this paper.

The core of the model is the theory of delegation: principal engages the agent to delegate some activities on him to do for a particular compensation. In such relation there is cooperation in common objective – the best result, but also the conflict in distributing obtained gains. The principal – agent relation is in fact a contractual relationship. In the case of public administration there are many types of those contractual relationships – relation between the central government and local governments, between the governments and the providers of public goods and services, between the government and the bureaucratic structures that the government exploits.

The government activities are usually permanent, steadily repeating, and so there is a space for concluding contracts longer than single ones. The longer the period for contract is the wider is the space for so called contract opportunism. The contracts can be Pareto optimum ones, or they can be classified as ex-ante opportunistic or ex-post opportunistic.

Government as a principal is totally stalled by policy. It needs a lot of people who will make things move. These people are either civil servants or employees of business sector or of non-profit sector. All those people will participate on providing public goods and services. The key question is then – how much to pay and for what outcome? Principal – agent model is closely linked to asymmetric information and also to contractual opportunism (the aim to obtain more than the moral gain is).

Asymmetric information in principal – agent model can have several levels – asymmetric information between the principal and the agent, on the side of agent (he may not know what his position is in the total structure of relationship and where other participants are. Principal may not know the volume of agent's activities, the agent may not know all aspects of the governmental task, and both parties may not know all the alternatives of the activity and of the potential outcome.

In principal – agent model the key unit of analysis is effort, because particularly effort can explain why so many contracts fail. We can come from the fact that the outcome depends on effort and the value of a particular result is the basis for payment to the agent. The effort can be low or high. The principal claims the agent with high effort. But this is to be followed by higher remuneration so as the incentives were compatible on both sides of the contract. Contract opportunism in this case means that the agent wanting high remuneration can possibly give either high or low effort, but maximization of his utility function leads frequently to requiring high remuneration for low effort. The relation between effort and remuneration is very instable, depending not only on the characteristics of the principal and

the agent, their opportunistic behavior and effort, but also on other factors strengthening asymmetric information, as the number of potential agents and principals, and their possible strategies. Contract opportunism can lead to extensive losses for the principal, especially when he required high effort in the contract, and then he obtained low effort.

2.1 Moral hazard and adverse selection

Having asymmetric information we can come to moral hazard and adverse selection. Moral hazard can be expressed for instance by changes of agent's behavior after concluding contract. Adverse selection can be seen in the fact that the principal does not know which types of agents he concluded the contract with. In practice there exist various other expressions of moral hazard and adverse selection. Moral hazard can be seen in slackness of civil servants or other providers, public sources prodigality, bureaucracy or X-inefficiency. Adverse selection can be seen in engaging agents, both in public administration and private sector. It is the main problem in concluding contracts, because contract mistakes must be corrected later on, as transactional costs can exceed gains. Moral hazard can be expressed as contractual opportunism in the form of infringing the contract or pretending. This can lead to inefficiency that causes extra gain for the agent. Both parties can breach the contract if they want to avoid fulfilling the terms of contract. The opportunism can be ex-ante (leading to lying) or ex-post (leading to cheating).

Contracts between principal (government) and agents should specify desired outcome and remuneration. The contract reflects bargaining force of principal and agent, it can also reflect the probability of moral hazard and adverse selection, but monitoring those phenomena is almost impossible in practice. Nevertheless, the reform of public administration should destine for extending the process of contracting out, keeping for the government the possibility to choose external providers and to control them, while the receivers of those public goods and services did not come to the risk of non-providing or worse providing of them.

There is a difference among providers – public goods and services can be provided by private firms, non-governmental organizations and non-profit organizations. Each of those units has its own complex of motivation, and then the orientation on innovations and efficiency. Private firms probably seek for profit. They can reach it either by decreasing costs or at the expense of government objectives. Non-profit organizations usually follow similar objectives as the government, so they should be more reliable partners, but contract opportunism can be present there again, in spite it may not be so intensive. If the contract

were long-range, there is a risk that the non-profit organization starts to behave as a standard monopoly so as to keep the influx of public sources, which can lead to inefficiency, lack of innovations, weak incentives and increasing bureaucracy, it means to such consequences that can follow government's providing those activities that the government wanted to avoid by delegating the providing on external firms.

3 Asymmetric information in contracting out in the Czech Republic

The typical situation of delegation competences and responsibilities in providing public goods and services is contracting out. Engaging external firms for this come from the idea that governments are internally inefficient, so contracting out can lead to increasing efficiency and decreasing costs of providing public goods and services. It can also lead to extended choice of provided goods and services, improving performance and quality. Another benefit can be a higher flexibility of public institutions to adapt to changing demand for public goods and services, government focusing on key activities (especially those where the role of the government is irreplaceable, monopolistic) while delegating other activities to external providers. This can enable higher performance both in government key activities (thanks to specialization of some kind) and external providers. If activities delegated to external providers are peripheral activities, asymmetry of information is not so important there.

In opposition there exist pretenders of contracting out arguing that external providing can lead to sacrificing key values of public interest (for instance the equity of care, justice, social harmony), and to decreasing capacity of provided public goods and services – both of those can come to worse availability of public goods and services to all members of the society.

Contracting out in the form of public procurement in the Czech Republic is the field of public administration where the space for asymmetric information can be relatively very wide. Besides that there is also a big possibility to come to moral hazard and adverse selection, and also to unethical behavior.

The volume of public procurement in the CR is about 650 bil. CZK per year. There are expert estimations that 10-20 % of them are far more expensive, and the process is massively followed by corruptive behavior.

Looking for the mechanism of contracting out, it is necessary at first to describe the legal framework of public procurement. The development of legal norms beginning in the recent history can be put to 1994, when Act No. 199 was approved about ordering public

procurement. It was novelled several times (12x), and gave such terms as effectiveness and efficiency, transparency, equal treatment of applicants and competitive environment, later on it brought harmonization with some EU norms, especially in the field of monopolies.

In 2004 Act No. 40 was approved, again followed by several novellas (at least 8), and at last in 2006 Act No. 137 was set by the Parliament. This Act is valid till today, but at least 16 novellas again mean that there is not a stabile legal framework, and taking into account the complexity and complicated process of public procurement; we can say that the space for asymmetric information is very wide and legal acts do not contribute to overcoming it. Besides that there is a specific situation now given by the fact that the last novella (55/2012 Sb.) is valid from April, 1st, 2012, but it is not completed by adequate implementation instructions till today. Those two parts of regulating public procurement (legal act and implementation instruction) are in a relative conflict, because implementation instructions stayed the old ones while legal act is new, and so a bit different. So then it is possible that when an applicant for public procurement prepares his offer in harmony with the legal act, it can be in conflict with implementation instructions, and opposite.

The main objective of the last legal act was to withdraw corruption field, and make the care of public wealth more efficient. The number of novellas makes the legal framework very unstable and confused for potential applicants.

So in spite of existing legal acts the problem of asymmetric information was not overcome. This fact is given by several reasons:

- uncertainty given by steadily changing legal conditions (4 and more novellas per year),
- surviving unfair practices in selection procedure,
- the main reason then is that none of legal acts concerning public procurement withdrew the possibility to apply for it the firms with anonymous shares (even the last novella had originally this requirement, but at the approving process this paragraph was cancelled again, shortly before voting for the act).

So we can say that the space for asymmetric information, moral hazard, unethical behavior, illegal practices, low efficiency, and high public costs is still open in the Czech Republic, strengthened by the tendency to tighten interest groups and structures.

Conclusion

Asymmetric information can take place on various stages of contracting out process. Overcoming the consequences of asymmetric information is possible, if we are able to

analyze the mechanism of asymmetric information working, and its consequences, and if there is a willingness to overcome asymmetric information.

Majority of cases of contracting out process can be analyzed in the form of principal – agent model, especially when the objectives of principal and agent are different, or even in conflict. Concluded contract should ensure cooperating relation between principal and agent, but it often does not work. The agent realizes his own objectives and contract opportunism can take place there. This leads to delegation costs (in the form of additional incentives or monitoring costs).

Overcoming the problem of asymmetric information needs to set up a proper type of contract based either on behavior (ex-ante contracts) or on result (ex-post contracts), for adequate period of time (repeating contracting out procedure is useful for overcoming dominant position of a particular provider). Then the contract must enable rational monitoring, long-run contracting should be followed by regular controls, and the best cost-saving method is to base the contract and relations between the government and providers on reliability.

Principal – agent model can include also Public Private Partnership and the other way how to save public sources is to enable private units to do business in some fields of interest originally realized by the government. There are several niches on the market of social services that can bring interesting profit incentives, and so it is necessary to exploit those chances for private business on this field. New needs, changing demand for public goods and services can serve as a basis for new forms of business. This is also one way how to overcome asymmetry of information and to reach high efficiency. The claim is not to reduce the volume and structure of provided public goods and services,

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