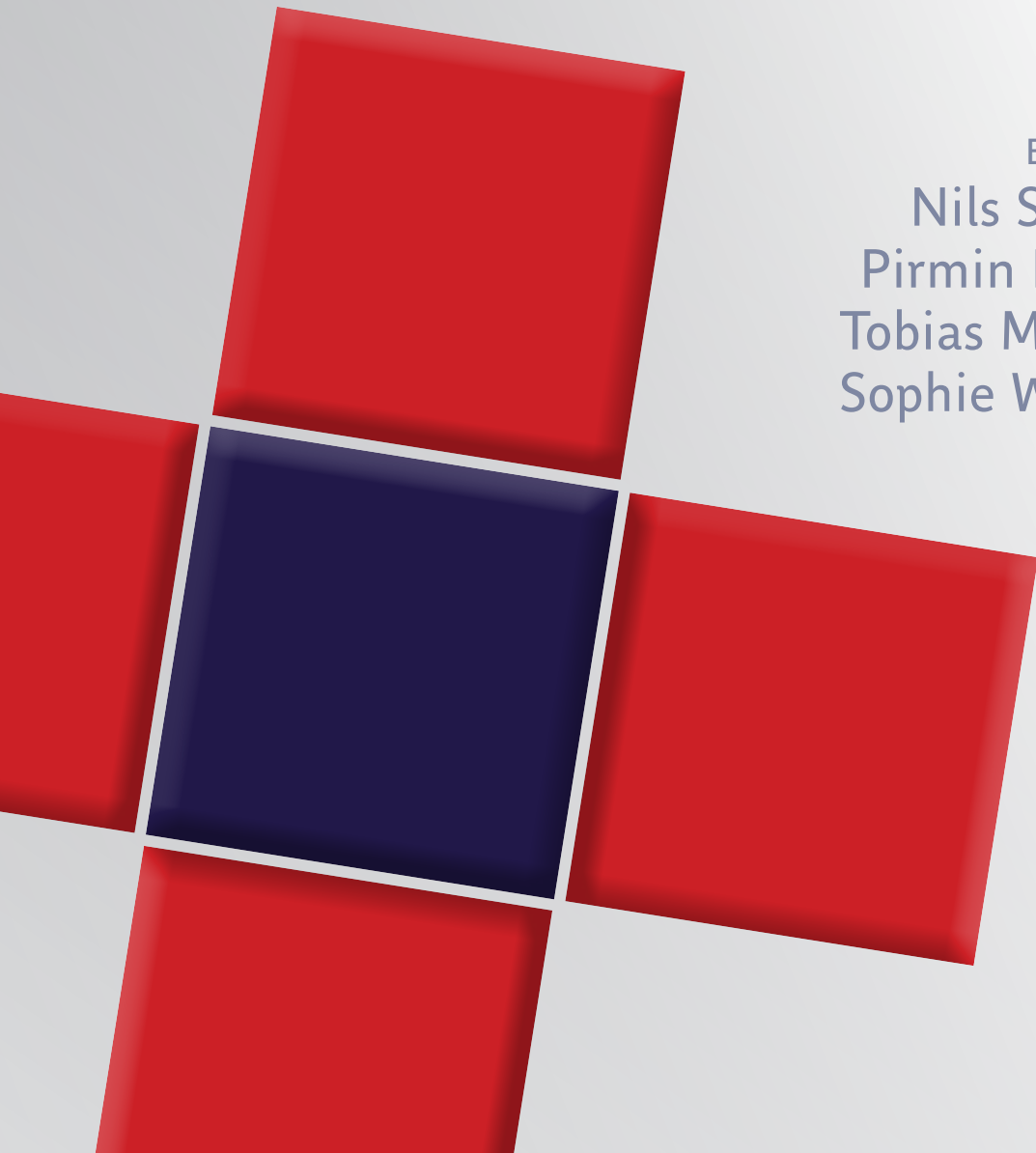


Understanding and shaping public administration: **The IDHEAP model**

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2 Essential functions

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2.1 The importance of knowing the reasons that make state intervention necessary

More government! Less government! Two cries often bandied about by people with opposing viewpoints. These hackneyed slogans are of course based on ideological biases. But they are of no use in determining whether or not the state is in phase with contemporary society. It would be worthwhile to reflect on the state's role and missions. The state cannot exist for itself. It was created to respond to the needs of society and resolve collective problems. This is its *raison d'être*, that which legitimizes it in the eyes of citizens. From this point of view, this contribution is completely in keeping with the IDHEAP model of public administration, and more particularly with the part devoted to the context and environment in which public administration is exercised. Having a clear view of the state's essential functions can tell us whether state intervention is *a priori* necessary or whether a matter can be entrusted to private actors alone.

Article 5 of the Federal Constitution asserts that the principle of subsidiarity must be observed in the allocation and performance of state tasks and that "all activities of the state are based on and limited by law." Be that as it may, the competencies constitutionally allocated to the state have widened over time. They are listed and defined in 72 of the 196 articles of the 2020 Constitution (art. 54 to 125).

This widening of competencies can be seen through the general government spending ratio indicator, which expresses state expenditure as a proportion of the country's gross domestic product (GDP). The evolution in this indicator for Switzerland during the second half of the 20th century is shown in Figure 2.1 and is compared with that of the average of member countries of the Organisation for Economic Co-operation and Development (OECD), for which we have data going back to the beginning of the 20th century. State expenditure has constantly increased as a proportion of GDP, rising from 11% in 1900 to 28% during World War II, falling

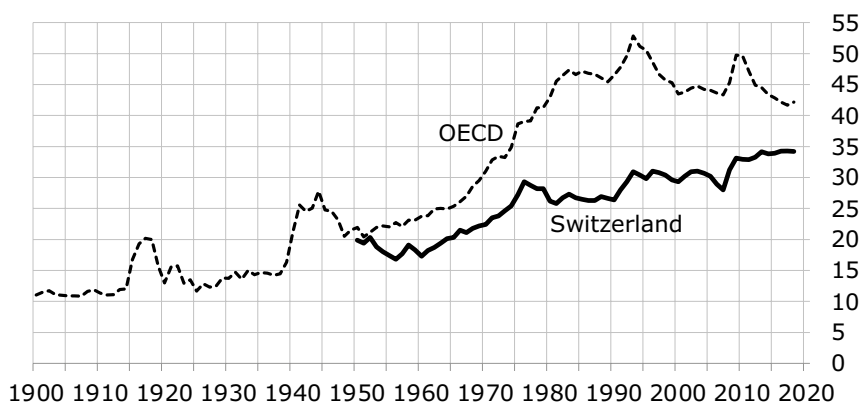


Figure 2.1 Evolution of the general government spending ratio
Source: Federal administration and the International Monetary Fund

back to 17% in Switzerland in the mid-1950s and reaching 34% at present, as against an average in OECD countries of 42%. This increase illustrates the changing role of the state. Within a century, we have moved from a night-watchman state to a welfare state, even to an enabling state. A hundred years ago, the state exercised sovereign functions: justice, police, national defence. Today, it has become—among other things—an entrepreneur tasked with making infrastructures and services available, and also a manager of income and wealth redistribution, in other words, an agent of economic and social transformation. Although the degree of state interventionism varies with the period and the complexity of the problems to be solved in an increasingly globalized world, it also varies with places and development levels. Compared in terms of the general government spending ratio, English-speaking countries tend to be more liberal (for example in 2019: United States, 38%; United Kingdom 41%) than the average of European countries (47%)².

That being said, the government spending ratio shows just how much state intervention is deemed necessary to improve collective wellbeing. The underlying theme, regardless of any ideological reference to “less government” or “more government”, is the difficulty that the market faces in spontaneously reconciling personal interest with the common interest.

There are circumstances in which free, voluntary transactions between households and businesses—designated in abstract fashion by the notion of market—pose a problem from the collective point of view. Musgrave (1959), an American economist of German heritage, proposed a typology of reasons for which state action may prove necessary³.

² <https://ec.europa.eu/eurostat/fr/web/government-finance-statistics> (accessed 16.11.2022).

³ These reasons are founded on the goal of ensuring the population’s maximum wellbeing. This economic and normative approach must not be confused with reflections in political sciences on the legitimization of the action of public administrations through the political process (Scharpf 1999).

This typology has three categories:

- Cases in which state intervention is necessary for reasons of *efficiency* in the use and allocation of resources⁴. This is because exchanges between households and businesses may affect third parties who have not given their consent, or may be carried out without full knowledge of the implications, or may be dominated and manipulated by one of the parties to the exchange.
- Cases in which intervention is necessary for reasons of equity in the *redistribution* of income and monetary and non-monetary wealth between individuals or between regions. In their transactions, households and businesses generally do not concern themselves spontaneously with questions of equity.
- Cases in which intervention is necessary for reasons of *macroeconomic stabilization*, particularly of the business cycle and growth.

This typology is widely used outside economics circles to analyse the reasons justifying state action. This contribution explores these various reasons. It also proposes instruments for intervention by the state, and by its public authorities, that is appropriate to these various cases, concluding with the major challenges for which states should prepare themselves.

2.2 Key reasons for state intervention

2.2.1 Intervention to guarantee efficiency in resource allocation

Providing an incentive to take externalities into account

The behaviour of households or businesses frequently affects third parties who have not been consulted. Cases of pollution are the best example. Pollution victims' well-being is affected without consideration by the consumers or producers at the cause of the phenomenon (i.e. they do not spontaneously take this into consideration and offer compensation). This is a typical case of a negative externality. The price paid by consumers, or the production cost borne by firms, does not reflect this external effect. In the absence of state intervention, this situation is inefficient: behaviours that generate negative externalities should be discouraged.

4 With regard to resource allocation, the question is not solely to determine what productive resources (work and capital) must be called upon to produce goods and services. This first component of the problem—how to produce—is merely a matter of efficiency. It is also a question of determining what goods and what services must be produced using the available productive resources, for the purpose of best satisfying the population's needs. This second aspect of the problem—what to produce—is added to the first in the wider search for efficiency. As for issues of equity, these are concerned with redistribution of income and of monetary and non-monetary wealth by the state. A specific category in Musgrave's typology is devoted to this problem.

In contrast, the behaviour of households or businesses can indirectly improve the welfare of third parties who have not been consulted. Anyone who gets vaccinated contributes to reducing the spread of the disease concerned and to protecting the rest of the population. This is an example of a positive externality. Individual vaccine behaviour tends to ignore this collective effect. The state should therefore act to encourage behaviours that lead to positive externalities, and preventing vaccination levels from falling below a certain threshold is efficient.

Various public intervention tools can give households and firms an incentive to take the external costs and benefits of their behaviour into account. Examples are taxes or subsidies aimed at internalizing external effects. Harmful behaviour can also be limited or prohibited by legislative measures (environmental norms, standards, quotas). Conversely, measures can force the adoption of behaviours that generate positive externalities (for example, compulsory vaccination).

Providing public goods

The market is also at fault when it allows “freeriding”. A freerider is an individual (or business) who enjoys a benefit without paying the price. This type of behaviour is possible in the case of so-called public goods. Public goods have two characteristics (Stiglitz 2000: 80). On the one hand, the benefit that a person derives is not to the detriment of other users: this is an example of *non-rivalry in consumption*. On the other hand, it is not possible—technically and at reasonable cost—to prevent someone from benefiting from the good, even if that person refuses to pay the price: *exclusion is impossible*.

Broadcast radio, public security, a firework display, street lighting, national defence and a healthy environment are all examples of public goods, whether or not they are supplied by a public authority. The area served by a public good varies in size: it can be global (planet-wide), such as the fight against climate change; continental, as with missile shields; national, as with national defence; local, as with street lighting and street cleaning. A good can also lose the characteristics of a public good as a result of technological change. Until 2019, anyone with a television set could access programmes of the Swiss Broadcasting Corporation (SRG SSR) through digital terrestrial television (DTT), with no technical possibility of exclusion. Since 2019, DTT has been abandoned in favour of cable, satellite and internet broadcasting, which make it technically possible to exclude those who refuse to pay for programming.

Thus, by virtue of its characteristic of non-rivalry, a public good is provided solely in a single form, a single quality, a single quantity, from which all can benefit. But the price that people are prepared to pay to obtain this public good varies between individuals. To take national defence as an example, all the residents of a country are provided with the same service, but those who fear insecurity place a higher value upon it than those who feel less threatened. However, although the good in question is of value in the eyes of most, the property of non-exclusion means that people

prefer that others pay for it. There is therefore a divergence between personal interest, which urges people to adopt “freerider” behaviour, and the common interest, which would have everyone contribute to the funding of the public good.

Consequently, without state intervention, public goods would in principle not be supplied and the situation would be inefficient. The solution is to use the state’s coercive power to fund public goods through taxes, so that everyone contributes and is deprived of the opportunity to act as a freerider. Once funding is guaranteed, what remains to be determined is whether the government should supply the public good itself or whether it should hand over responsibility to a third party. This is the subject of the contribution devoted to governance (► 8 Governance).

Reducing information asymmetry

Another type of strategic behaviour leads to market inefficiency: taking advantage of information that has not been shared. Examples of unequal distribution of information are numerous, particularly in consumer-provider relations: the executive of a company (public or private) knows more than anybody else about the true structure of production costs and whether the prices imposed on customers are justified by the imperative of covering costs; motorists know better than their insurer whether they take risks when driving; those who contribute to public health insurance or a private plan know better than the insuring organization whether they need dental care, vision care, etc. A striking example of strategic behaviour due to information asymmetry is provided by the prominent car manufacturer who rigged its vehicles’ engines to falsify the results of pollution tests.

Those who hold an information advantage are therefore tempted to cheat in order to increase their profit or other gain without the risk of sanction. But when the cheating comes to light, a major crisis of confidence may arise. Moreover, since goods of varying quality may hide behind a single price, consumers may base their willingness to pay on average expected quality. This willingness to pay may not suffice to cover the production costs of vendors of quality goods, potentially leading them to withdraw from the market⁵.

Information asymmetry therefore leads to inefficient situations. However, intervention by public authorities is not always necessary in order to remedy matters. Private solutions to the problem of information asymmetry exist, such as certification, quality labels and the sharing of experiences⁶. All these seek to create confidence in the product sold. In the field of insurance, market segmentation solutions enable the insured to choose the policy (high deductible and low premium or low

5 Akerlof (1970) shows the conditions in which a laissez-faire market (one without external regulation) can be not only highly inefficient but could sometimes even disappear completely, should buyers no longer wish to make transactions.

6 Online platforms such as Tripadvisor, Airbnb and Uber typically offer the possibility of reducing information asymmetry by relying on the experience of other customers.

deductible and high premium) that suits them personally and, in doing so, reveal their level of risk.

Public authorities may also intervene by setting standards and ensuring that these standards are observed (for example, the quality of life in medico-social institutions in Switzerland is governed by cantonal-level standards), by subsidizing organizations that uphold consumers' rights, or by accrediting certain professions in order to underwrite the quality of training provided.

Regulating natural monopolies

Another source of inefficiency is present in situations in which a company has the power to dictate the nature of transactions. An extreme case is that of a monopoly that makes competition imperfect. A monopolistic company can misuse its market power to gain profits by imposing higher prices or inferior quality on consumers.

Most often in this situation, the challenge will be to ensure that a reasonable number of companies remain active on the market concerned, or to limit the monopolistic company's power to influence the market, whether in terms of price or quality. In Switzerland, the task of overseeing the proper operation of markets is assigned to the Competition Commission (COMCO).

The situation is quite different when the service to be produced gives rise to substantial economies of scale. In this case, unit production cost decreases as production increases. Consequently, a single company can produce at lower cost than several companies could. This phenomenon arises particularly when fixed costs are high (e.g. transport, water or electricity infrastructures). It then becomes more efficient—more natural—to have a single company active on the market. A natural monopoly, guaranteed and regulated by the state, must therefore be set up (see Athias and Wicht [2019] for a problematic case of the creation of a natural monopoly in the field of district heating).

This makes it important to distinguish between institutions like COMCO (who enable the proper operation of markets) from institutions set up due to defective markets stemming from a natural monopoly. In the second case, public authorities must play an essential regulating role. They must supervise the monopolistic company and oblige it to provide a price/quantity combination that is optimal for society. However, because of information asymmetry, such regulation is a complex task. In Switzerland, the task is entrusted to independent commissions. For example, the Federal Electricity Commission (ElCom) is the independent federal regulatory authority for electricity. It monitors compliance with the Federal Electricity Supply Act and the Energy Act, taking whatever measures and decisions are necessary for the purpose. It controls electricity prices, rules on disputes concerning access to the electricity network and adjudicates in cases of differences of opinion regarding cost-price remuneration for electricity from renewable energies fed into the network. It verifies the country's electricity-supply security.

2.2.2 Intervention to redistribute income and wealth

Equity in income and wealth distribution of and the need for state intervention in the matter are hotly debated issues. One thing is certain, however: in the absence of state action, the distribution of income and monetary and non-monetary wealth depends first of all on individuals' natural endowments (their physical and intellectual capabilities or the patrimony that they have amassed or inherited). Then, distribution depends on the dynamics of accumulation that vary with opportunities provided by the market (labour market or capital market, for example).

French economist Piketty (2014) described this phenomenon using historical data. He criticized the growing inequalities it creates and the threat that these inequalities pose for the stability of contemporary democratic societies. The figures show that, in Switzerland, inequalities regarding the distribution of income and wealth have not grown over the past two decades. Moreover, Switzerland currently sits at the European average for inequality in the distribution of available income⁷.

Labour-market conditions in Switzerland (participation and wage-distribution rates) and the policy on training have made it possible to prevent a rise in inequalities. However, state interventions have been the primary factor in curbing the growth of inequalities. These interventions have been numerous. Among the elements that contribute to disposable income are family allowances, OASI/DI benefits, old-age allowances, employment-insurance benefits, social assistance and tax credits. Among deductions from disposable income are compulsory social-insurance contributions, income taxes (including the strongly progressive federal income tax) and health insurance premiums. Then there are financial-equalization transfers. These provide funds to jurisdictions whose resources are limited by low tax potential. Lastly, public authorities create redistribution through various public goods provided free of charge or at a modest price: education and retraining, subsidized housing and health services, public libraries and sports facilities, public transport, etc. Since these services are largely funded by income tax and most used by modest-income households, they have a progressive effect in terms of redistribution.

Human and financial efforts deployed by the state testify to a collective desire for redistribution. Only the state can introduce a social contract aimed at providing protection against global hazards that are difficult to predict: inequality of opportunity, impoverishment, mass unemployment resulting from a recession, etc.

That being said, tolerance of inequalities and means of redistributing income and wealth vary with regions and epochs. They depend on the prevailing philosophy regarding social justice, risk aversion and value judgments.

In theory, a conflict of aims arises between equality and efficiency. For example, although the prospect of wealth provides an incentive for effort, progressive income

7 See the page on "Income distribution" on the Federal Statistical Office website: <https://www.bfs.admin.ch/bfs/en/home/> (accessed 17.01.2023).

tax favouring redistribution may prove inefficient, since it may discourage effort. This is the point of view advanced in particular by Friedman (1962). This American economist, a Nobel Prize winner, also emphasized the virtues of private property and economic liberalism. He did however acknowledge that society requires a minimum level of social justice in order to function. Extreme inequality discourages those of moderate means from making efforts, because it wipes out the prospects of financial and social advancement.

Be that as it may, the redistribution mechanisms in place can always be improved and work more effectively. In addition, dilemmas persist, such as the choice between universal access to social benefits and access subject to means. Lastly, a multiplicity of redistribution measures can potentially generate inconsistencies and dysfunction, leading ultimately to poor targeting and dispersal of resources.

2.2.3 Intervention to stabilize the economy

The general government spending ratio alluded to in the introduction is an indicator of the effect of public expenditure on macroeconomic issues, in particular the goals of high employment levels, strong growth, price stability or balance of (external) trade. Attaining these goals is not straightforward. Perhaps it might be, were the axioms of classical economic theory to prove true in practice, particularly with the presence of rational, perfectly informed, mobile and flexible economic agents. The reality, however, is different. Individuals are prone to errors of judgment; they are driven by reptilian-brain reflexes and herd instincts. Their capacity to adapt is limited. The same goes for companies. Imbalances, occasionally substantial, occur between supply and demand, leading to prolonged periods of unemployment and inflation. Due to their sheer numbers, the millions of consumers, producers and investors are unable to coordinate their efforts spontaneously to correct the situation. The state has a role to play in stabilizing markets, both when expenditure levels are insufficient to guarantee full employment and when they are excessive, causing inflationist tensions. A variety of instruments allow the state to take on this role, chief among them budgetary and tax policy, in the hands of public authorities, and monetary policy, in the hands of the central bank (the Swiss National Bank).

The ideas of Keynes (1936) have left their mark on the fiscal policy of public authorities. They have also found their way into the Federal Constitution, which stipulates that “[t]he Confederation, the Cantons and the communes [municipalities] shall take account of the economic situation in their revenue and expenditure policies” (art. 100, para. 4). Whereas Keynes advocated supporting global demand, by means of consumption or investment by public authorities, the Constitution does not prescribe any particular mode of intervention. This omission reflects both the political and the legal difficulties of increasing or curbing expenditure (or, in the reverse order, the tax burden) in a discretionary manner quickly enough to

successfully follow Keynesian precepts. The Swiss federal structure further increases these difficulties of vertical and horizontal coordination. Automatic budget stabilizers already present in current legislation offer a spontaneous countercyclical fiscal response: expenditure, particularly social and health expenditure, increases in a recession and diminishes in an upturn; income moves in the opposite direction as the tax base contracts and expands.

In normal times, that is, except in major crises, some believe that the monetary policy, combined with the effects of automatic stabilizers, is better able to fulfil the state's mission of economic stabilization than discretionary fiscal policy.

Considering the Swiss context, however, stabilization capacities must be seen as relative. Globalization accentuates the characteristics of Switzerland's small, open economy. Consequently, macroeconomic balances are increasingly dependent on the spillover effects of other countries' fiscal and monetary policies. Expansionary fiscal measures taken abroad stimulate overall demand in Switzerland through exports. In contrast, the same measures taken by Swiss public authorities have a limited effect due to the fact that they are of some benefit to foreign actors because of the dependence on imports.

2.3 Future prospects and challenges

Here we have addressed the circumstances in which state action proves necessary. There is however a risk that such action will take on a life of its own, and that public administration will end up losing sight of its purpose, running counter to the common interest that was its initial justification. For example, even today, some states subsidize fossil fuels (gas, coal, oil), responsible for 67% of greenhouse-gas emissions. A primary challenge for public authorities is thus to be able to call into question instruments put in place in former times but that have today lost their relevance (as the result of technological progress, for example). This task can prove complex if governments are captured by private interests (e.g. election campaign funding, lobbies) to the detriment of the collective interest and if, in a democratic system, a pre-occupation with being elected or re-elected takes precedence. In this way, market failures may be replaced by—or, worse, compounded by—state failures.

Another major challenge states face is the provision of public goods with an increasingly global scope: financial and economic stability, health, education, climatic sustainability, to name but a few examples. The more global the public goods to be supplied become, the greater the difficulty of ensuring the supply of an optimal quantity. For example, to combat climate change, a unilateral policy would shift production to countries facing shorter-term imperatives than climate issues. Such policies are bound to lead to simple redistribution of production and wealth, with

no significant environmental benefit. To prevent this situation, supply of this type of public good must depend on worldwide agreements under the jurisdiction of supra-national authorities with the power to impose penalties in case of noncompliance. Failing this, incentives to act as freeriders will persist.

This challenge brings states face to face with another: that of trust. Aghion *et al.* (2010) demonstrate a causal relation between trust and regulation. By trust is meant a belief that stems from the civicness present in a society. The higher the proportion of civic people in a society—those whose behaviour takes into account the negative externalities they create—the higher the level of trust will be. Regulation serves to constrain antisocial people and limit the negative externalities they generate. Thus regulation—which always has a cost—intervenes in the absence of civicness and social conventions. State action is hence often a substitute for social conventions. A major challenge for the state thus lies in participating in the supply of increasingly global public goods while understanding that the institutions to be put in place to supply them cannot be the same everywhere, but must be adapted to suit local social and cultural contexts.

Key concepts

- General government spending ratio (*quote-part de l'État, Staatsquote, quota d'incidenza della spesa pubblica*): a statistical indicator that expresses all public expenditure made during a year as a proportion of GDP, that is, as a proportion of the added value created in the country during the same year. It takes into consideration total expenditure—that is, current expenditure and investment expenditure—in all sectors: confederation, cantons, municipalities and social-security funds.
- Macroeconomic stabilization (*stabilisation macroéconomique, makroökonomische Stabilisierung, stabilizzazione macroeconomica*): state intervention aimed at limiting cyclical fluctuations of economic activity, particularly by maintaining high employment levels and price stability. It is also aimed at fostering growth. Various instruments exist to serve this purpose, particularly the budgetary and tax policy of public authorities, and the central bank's monetary policy.
- Market failure (*défaillance du marché, Marktversagen, fallimento del mercato*): a situation that arises when market mechanisms alone, particularly the interplay of supply and demand, are unable to guarantee a socially optimal (that is, desirable) quantity and equilibrium price. Market failure occurs when the behaviours of companies or households generate externalities, or when information asymmetry exists between the parties to an exchange, or when a natural-monopoly situation exists, or when a good takes on the characteristics of a public good. The

state is generally expected to intervene to remedy such failures, thereby fostering efficiency in the allocation of resources.

- Redistribution (*redistribution, Umverteilung, redistribuzione*): state intervention aimed at fostering a degree of equity in the distribution of income and monetary and non-monetary wealth between individuals or between regions. This transferral function is assuming growing importance. It can make use of various mechanisms to achieve equitable redistribution, such as income and other taxes, social benefits (social assistance, unemployment benefits, etc.), or financial-equalization transfers between jurisdictions.

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