

CRAVING FOR BALANCED PUBLIC DECISION-MAKING ON MARKET FAILURE PERTAINING TO THE INTERVENTIONIST ECONOMIC POLICIES' STRAINER

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Abstract. *The research proposes a topic of very high interest for both our national economy and the European economy as it refers to the negative externalities and their role in the economic theory of subsidiarity developed as part of the multilevel governance. The case of the negative externalities represents one of the six situations of market interventions (due to the non Pareto efficient status) and, moreover, their specific case (pollution) is on the priority list of the European Union (Treaty establishing the European Community (Art. 174/130r – EC Treaty establishing the polluter pays principle (PPP)). Romania does not have a broad experience in this area (as it is also a new Member State) or if it has it is one that has confirmed our lack of expertise (e.g. the case of the eco-duty). In order to contribute to knowledge building in this field, the project aims at developing a methodology in the area of public decision-making for a particular market failure (externalities/spillovers) by appealing to the instruments provided by the multilevel governance vision and its subsidiarity principle so to provide a more efficient relationship between the costs and the benefits of a solid environmental policy. This methodology, imagined as a decision map, must provide a correspondence between the procedural part of the decision-making (correlating the national and the European level) and the formal part consisting in a formula that weights the elements that the research finds important. This particular manuscript is a work-in-progress as it puts forward the results we have reached so far as part of a post-doctoral research. The work proves valuable as it substantiates the theoretical framework needed for the final part of the research, which will be testing the decision map. Consequently, this research was undertaken by foraying the field literature and challenging the findings on a theoretical level. It must be underlined that the findings are purely speculative and shall be listed as valid only after performing the data testing. At the same time, we should also add that part of the model has been already validated in a previous research, but the test only targeted a niche-case, namely the eco-duty.*

Keywords: market failure, regulation, public decision

JEL classification: H23; H83; K23

1. Background

The most striking feature of today's communities is their constantly changing nature. Decade after decade the demographic changes have turned villages into cities, cities into metropolises and those into regions. The physical features are subjected to changes, often the once known areas become unrecognizable. Less obvious, but equally important are the structural changes within a society that comes with the growth or decline measured in terms of both population and facilities. From an institutional point of view, more and more innovations of the local public administration are being designed so to catch-up with the problems created by the greater complexity of mainly the urban life (Dinu, 2011). For example, the public education or health

system had to expand their coverage over the past decades, and, at the same time, have been taking different forms so to provide the citizens with a broader choice. The public institutions and authorities must answer these needs for social organization of the local communities triggered by the above mentioned changes. Thus, as a good administrator, its mission is to find a balance between the three Cs, namely coverage, choice and cost.

Many of the changes that seem so abrupt are triggered by ecological processes and the state, through its regulatory function aims at reducing this negative externality (like pollution). The citizens and the private organizations, as part of their individual development make decisions that when collectively taken they deeply affect the physical and social community structure (Edwards, 1954). The market or distribution decisions of an industrial organization can either bring prosperity or damage a certain community. At the same time, the individual migration decision can either depopulate an area or flood a labor market. Such changes, though they make sense on the individual's level or on the level of the local community, they are senseless on the above regional level but, nevertheless, the impact of such decisions can be quite grand.

In order to substantiate the *importance* of the problem nowadays, the aim is to review the research in the field of public decision-making pertaining to negative externalities, choice of alternative actions directed towards the institutions on both regional and central or local level. The negative externalities give a focus to this research due to their role in the economic theory of subsidiarity developed as part of the multilevel governance. In this regard, the negative (trans-frontiers) externalities represent an assigning criterion based on the subsidiarity principle, especially referring to the 'beggar-thy-neighbor' policies, namely air or water pollution and commercial protection (Pelkmans, 2006: 5).

The *question* raised in this particular case mainly concerns one of the state's four functions, namely the distribution function, which embodies the decisions made to ensure equity, social justice and income distribution. Aiming at such a sensitive issue like equity, it can be said that in fact the public decision-making pertaining to this distribution function is strongly influenced by the political factor, more than other decision stages like building knowledge on public sector activities and design of operations (financing method, expenditures and local and central duties), anticipating the consequences (the effects of a tax on return – price increase, wage cut, increasing the retirement age), or assessing the alternatives (Matei, 2006: 63). These stages apply for all public decisions taken in the framework of the other state's functions. For example, in the case of the allocative function, due to the fact that the public decisions pertaining to this function aim at the government's intervention in the market's allocative function so to correct its negative effects (e.g. negative externalities), the stage referring to consequences' anticipation proves to be quite important (Matei, 2003: 26-27). A similar situation can also be found in the decision context of the stability function, which intervenes in case of macroeconomic imbalances seen in the case of inflation, unemployment, economic downturn, deficits of the trade balance and balance of payments etc. (Ailenei, 2002: 29). In turn, the public decisions pertaining to the regulatory function aimed at reducing the tendencies towards monopoly or, in the context of this research, the negative externalities refer to setting limits for the discretionary behavior and freedom of individuals by imposing certain rules (through a functional juridical system), thus emphasizing the decision-making stage that aims at building knowledge on the public sector activities and organization.

Going back to the public decision-making, no matter to which state function pertains to, the decision variables specific to the field where the decision is applied are difficult to be defined. In the public decisions' case the problems at stake are specific to both the private sector (efficient allocation, productivity, performance (Constantin et al., 2011)) and to the issues that only concern the public field (provision of public goods and services, collective choice, externalities). All in all, the public decision-makers dilemmas can be formulated as follows: What is to be produced? How is to be produced? For whom is it to be produced? How are these decisions made? (Stiglitz, 1999: 14). Therefore, the influence of each variable become important, be it

contextual (organisational culture, strategy, stakeholders, legislation, and so on) or which intervenes in the decision efficiency (economic and social status, technical parameters, so on and so forth). Thus, the answer to the first question (What is to be produced?) lies in the resource allocation, underlined in the field literature with the help of the Production Possibility Frontier (PPF) instrument. The second dilemma must search its answers in the combination of the production factors (labor, land and capital) captured by the governmental policies (e.g. the environmental policy adopted as a response to a specific negative externality may affect at least one C (namely, Choice of technology). The target group (For whom is it to be produced?) is defined by the distribution, which is equally influenced by the fiscal policy (e.g. eco-duty) or by the public goods provided so to satisfy the needs of certain groups – free rider problem (e.g. the Romanian Jalopy Program) (Dinu, 2011: 32-37). The decisions are collectively made ('tragedy of the commons') and, as mentioned above, have different stages: building knowledge on the public sector activities and operations, anticipating the consequences, assessing the alternatives and the influence of the political factor (Matei L., Dinu T., 2011).

The problem's elements of difficulty lay within the implementation of the policies avoiding or correcting the negative externalities. The multilevel governance system of climate policy presents both opportunities and challenges for policy makers [...] the capacity of decision makers operating at any one level can be enhanced or (more frequently) constrained by the policies at other levels (National Research Council, 2010: 318), e.g. the case of the Romanian tax-register (Dinu, 2011: 25-39). The same problem pertaining to the subsidiarity and the environment is underlined by Pelkmans (2003: 53) namely whether competencies should be assigned on the European Union's level with regard to following a certain environmental policy. Pelkmans best emphasizes the core of the problem in the case of the trans-frontiers negative externalities (most of them are from the environmental field): should the European Union have an exclusive competence considering the fact that the EU countries have different national characteristics? It would probably not happen mainly because at least a part of the environmental problems are local, regional or national, and their differences are best considered on those administrative levels.

Therefore, the same author reveals that when establishing the objectives, one must distinguish between three levels of externalities: bi- or trilateral, community and world. This approach of the collateral effect (externalities) narrows in a way the limits of the field research. It takes us to the above stages, namely cooperation, and when that fails (and it usually does when there are more than two actors involved) it comes down to the bargaining powers (Dinu, 2011: 28-30). In fact, the integration process is led by the collateral effects from a policy field to another (Molle, 2009: 34), as we shall present the case of the collateral effect from the fiscal policy to the environmental one.

2. The research aims

The overall aim of the project is to design a map of the public decision-making for a particular market failure (externalities or spill-overs) by appealing to the instruments provided by the multilevel governance vision and its subsidiarity principle so to provide a more efficient relationship between the costs and the benefits of a solid environmental policy. This map – as entitled in our project refers in fact to a specific methodology) – must provide a correspondence between the procedural part of the decision-making (correlating the national and the European level) and the formal part consisting in a diagram that weights the elements that the research finds important (e.g. the formula establishing the method of calculus for the eco-duty has led to its suspension for reason of conflict between decision level and stakeholders, as it does not take into account both the contextual variables and the technical indicators).

The *challenge* is to foray into both the field literature and the case study archives pertaining to the particular case of the eco-duties on both national and European Union level, following

actions like establishing fiscal rules either to give in to the bargaining power of the negative externalities' `producer' or to the bargaining power of the negative externalities' `consumer', thus reaching the *result* of keeping the cost of regulation to a minimum level so the market failure does not turned into a regulation failure.

The case of the negative externalities was picked out of the six situations in which the markets are not Pareto efficient - (1) Failure of competition, (2) Public goods, (3) Externalities, (4) Incomplete markets, (5) Failure of information and (6) Unemployment, inflation and imbalance – firstly because of its topicality and the intense debates that has been triggering in the EU-27 (Community guidelines on State aid for environmental protection 2008/C 82/01; Treaty establishing the European Community (Nice consolidated version) - Part Three: Community policies - Title XIX: Environment - Article 174 - Article 130r - EC Treaty (Maastricht consolidated version) establishing the polluter pays principle (PPP), and so on) and, secondly, for sensitive issue that the most well-known negative externality (pollution) has proven to be. The reason for its highly sensitive feature, which in fact allows the intervention, refers to both sides of a failure. One is that the best possible result was not reached followed by the necessity to act, and the other is that the actors involved are unable to cooperate.

The *outcome* of the project refers to a regulation strategy that can lead to the best framework in which the internal market can function, so that it reaches all three types of efficiency (technical, allocative and dynamic), effectiveness, economy, and equity. It goes without saying that the regulation strategy shall be defined only after establishing whether the regulation in itself can be justified, namely whether the market failure is overrun, the regulation is in its lowest cost version and its net benefit is positive (Dinu, Socol, Marinas, 2004: 142).

In order to reach the overall objective of the project, a number of six derived research *hypotheses* are formulated:

- 1) The economic theory of the European Union multilevel governance, with its core consisting in the subsidiarity principle, puts more pressure on the national distribution decisions, as they also include the integration costs, though it interferes with all state's functions and their specific decisions.
- 2) For the subsidiarity principle to be applied in the environmental field the European Union must have competence in the environmental policy field.
- 3) Though the integration led to a single market, it cannot be considered as governed by a single authority like is the case for a federation, but it is still a fact that it must deal with trans-frontier issues.
- 4) There is a growing awareness that the positive effects of a single market are offset by negative externalities.
- 5) The negative (trans-frontiers) externalities represent an assigning criterion based on the subsidiarity principle (Treaty establishing the European Community (Nice consolidated version) - Part One: Principles - Article 5 - Article 3b - EC Treaty (Maastricht consolidated version)), especially referring to the `beggar-thy-neighbour' policies, namely air pollution, and this provision is in itself a reason for the national economies to act should certain negative externalities occur.
- 6) The public decision on negative externalities' coverage, made in accordance with the economic approach of subsidiarity in the multilevel governance provides a balanced solution for all interested parties – citizens, economic agents and the government (establishing a map to cover the social costs created by the negative externalities should be in line with both the national and European decisions, but, at the same time, suspending that map when it is conflictive is not an answer; it would leave the social costs uncovered).

Therefore, the above hypotheses are formulated as a tether to the project's *secondary objectives* (SO) that help reach the overall objective. The research project is designed for a two year period and it follows a structure in line with these six objectives and their connected

activities. An overview of the field literature as well as aspects that have not been researched yet and we consider them relevant are provided. The first SO aims at analyzing the national distribution decision framework (e.g. decision on covering social costs) and its folding to the European framework. The second SO aims at estimating the impact of the subsidiarity principle in a field relevant for our research (Radu, Constantin, 2007), namely the environmental field. The third SO searches to identify the nature of the problems covered by the application of the subsidiarity principle in the environmental field (e.g. trans-frontier issues) and identify the specific sources of their creation. The forth SO pulls us from the existent literature and takes us to the analytical part of the project, namely the one aiming at testing the stakeholders perception on the project's main concern (i.e. the negative externalities) in the framework of the single market's effects. The fifth SO is the one aiming at already sketching a part of the project's conclusions and it examines the capacity of the European and national decision-making level to jointly address the negative externalities, thus covering the social costs they triggered for both parties. The sixth SO consists in designing and delivering a specific methodology (entitled a *map* in the project, Figure 1) for identifying both the cause and the effect of the public decisions on negative externalities' coverage.

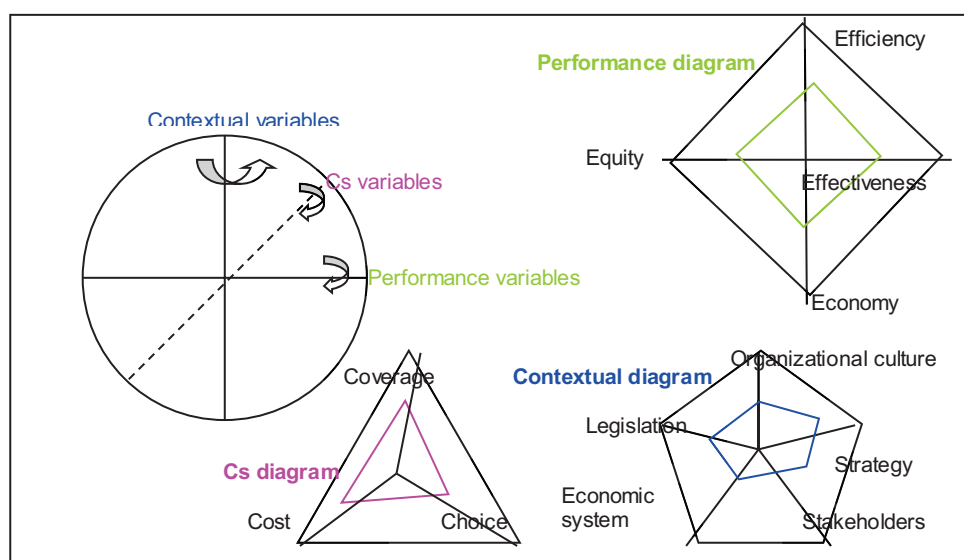


Figure 1. Decision map

Source: own elaboration using the graphic method to pinpoint the variables and polar diagrams to calibrate each variable

In terms of *innovation*, the project draws attention to the cause and only after to the cure. In other words, it appeals to the adverse method and therefore looks in-depth of the negative externality, namely the pollution, so that it will better provide a regulating solution. The adverse method implies a clear analysis of the negative externality so that the decision makers know what they are dealing with when designing public policies and implementing decisions in order to reduce the phenomenon. First look at the cause, not at the cure. The field research shall prove the focus of the current policies on the cure (fiscal policies, multilevel governance) (Blank, 2010; Pelkmans, 2003: 54-55; Termeer, Dewulf, Lieshout, 2010; Ostrom, 1990, Dietz et al., 2003; Dinu, Socol, Marinas, 2004: 142-146; Molle, 2009: 34-42; Miron, 2002: 453-465) and not on the cause (negative externalities) (Martinas, Matica, Srblijinovic, 2010:104-110; Pelkmans, 2003: 53-54).

The targeted *impact* is upon the public decisions pertaining to national fiscal issues triggered by the necessity to correct the market failure issue, namely the negative externalities and the failure of competition (like green taxes or Eurovignettes, and the cartels). Government's intervention is seen as a remedy only if it provides a net benefit that outruns the costs of intervention. Otherwise, the necessity to take action becomes the necessity to justify inaction.

3. Methodology

The investigation methods and instruments were selected so to best validate or invalidate all six derived research hypotheses. Their integration is accomplished in accordance with the 'zoom in' approach, from the big picture provided by the economic theory on subsidiarity in the multilevel governance to the narrow image of the national public decision on negative externalities.

Therefore, the first three research hypotheses had been tested by using a methodology consisting in a broad bibliographical study so that the reason behind the paper is clearly emphasized. Further, the research makes use of direct observation and analysis of legislative texts with regard to the public decisions in the fiscal and environmental fields.

The qualitative research had been greatly improved by using the search engines provided by the Legislative Council of Romania and by EUR-Lex, which allowed us to correlate the national public decisions with the ones made on an European Union level, go in-depth of the adoption, motivations and implementation timelines.

The forth hypothesis involves the use of a structured interview. This method was chosen because it allowed a reliable comparison between sample subgroups and survey periods. Giving the difficultness of the selected topic, a simple questionnaire would not have been a better instrument as the respondents may be in need of further clarifications. At the same time, in order to avoid unreliable answers, the sample had been selected only from public servants who were employed by units directly dealing with this matter. It must be underlined that the hypothesis that has been tested refers to the awareness of the field specialists. The respondents had been selected both from the national fiscal authorities as well as from the environmental and competition authorities. Testing the perception of the stakeholders becomes more and more important in the context of the current struggle to deliver a single market for consumers and citizens (2010/2011(INI)).

The fifth research hypothesis aims at an interpretativist work based on the documents gathered and the performed text analysis. Should the hypothesis be validated, an additional goal is to promote this type of methodology based on interpretativist research as a way to facilitate a better understanding of concepts, which will allow the transition from theory to practice. *This is still a work in progress.*

The sixth research hypothesis finds itself in the practical side of the project and is meant to become a case study fit for the seminars of the course held by the project leader (Public Economics and Public Law, in line with the field on interest of the authors). The used methodology also involves a qualitative research and takes the form of an interview. The interviewees shall come from all three areas that the public decision on negative externalities and failure of competition reaches: citizens, economic agents and government (the ministries and authorities in charge).

4. Limits and implications

The risks mainly referred to changes in legislation, both on a European level and on a national level. In order to cover these risks a careful monitoring of the field legislation was required. Moreover, for the methodology use, there were several risks involved and they mainly referred to a slight rejection of the investigation methods by the target group. For example, in the case of an interview, which can be considered a dull instrument by the interviewees, they tended to avoid the answers for reasons like time consumption or political pressure. In this sense, the

selection of the sample had been taken the main lead in the interviewing process. Field interviewers dedicated more time to closely select the interviewees. At the same time, the project leader reserved the right to also add other methodological instruments if needed. There were also risks concerning the scheduled timeframes, the research stages or the work visits that involve maintaining a contact with the host institution. To cover that risk a permanent dialogue had been established through a permanent contact in the Ministry of Finance and the Competition Council.

At first site, the lack of a clear understanding of the impact that the public decision on covering social costs triggered by negative externalities and the failure of competition could suggest a rather high risk regarding the project completion and revaluation of the result. Nevertheless, the way it is designed brings the risk to almost zero considering the competences of the Principle Investigator, Mentor, and fellow researchers' thorough structure, timelines and resources involved.

5. In conclusion

Public decisions pertaining to the regulation function on the state, aiming at reducing the monopoly tendencies or, in this particular case, the negative externalities, mainly refer to establishing the limits for the discretionary market behavior, by setting rules as part of a functioning legal system. This is an important step in the decision making process aiming at better knowing the public sector's activities and operations. The research topic is original through the perspective it offers by analyzing both the micro and macro effects that calibrating the economic policies to the complexity of the market failure have on the current conditions, thus adding to the traditional studies only examining the capacity of the economic policies to fulfill the criteria established by the economy's cyclical nature.

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