

Toward the Establishment of Policy Management Study (1): From Traditional “Policy” to Social Programs

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April 2007

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“Policy Innovation Initiative: Human Security Research in Japan and Asia”
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This paper is an English translation of Working Paper Number 76 (in Japanese), which has been published as Chapter 1 in Moriyuki Oe, Mitsuaki Okabe, and Michio Umigaki (eds.), Policy Management Study (in Japanese), Keio University Press, 2006. In the course of writing this paper, the author received the valuable comments of many researchers affiliated with the Ministry of Education, Culture, Sports, Science and Technology’s 21st Century Center of Excellence (COE) Program“ Policy Innovation Initiative: Human Security Research in Japan and Asia” research group, with which the author is affiliated. Among these, in particular, are Moriyuki Oe, Michio Umegaki, Tomoyuki Kojima, Jiro Kokuryo, and Fumiya Hirataka. Additionally, valuable suggestions were given by Iwao Nakatani, Takashi Shiraishi, Kiichi Fujiwara, Toshio Watanabe, Shigeru Itoh, and Tamito Yoshida at COE-sponsored symposiums, the symposium for reporting interim results, and other occasions. I would like to express my gratitude to them.

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Abstract

Measures that governments implement in order to bring the various problems arising in society to a resolution (or to prevent problems from emerging) have until now been referred to as policy or public policy. However, due to (1) the government's increasing information disadvantage accompanying innovations in information technology (IT) and (2) the increased scope in which nonprofit organizations (NPO/NGO) are able to more appropriately address social issues, there is a growing need to recognize that the solution to these challenges rests on “social programs” through which governments, nonprofit organizations, private enterprises and individuals collaborate in addressing such tasks. The appropriate frame of reference to understand issue resolution through various entities is that of “governance.” Policy management study is one new method of social science that provides this sort of problem-solving formula and translates it into action.

Key words: Policy management study, IT revolution, NPO/NGO, social program, governance, institution, credibility, incentive

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Introduction

Contemporary societies are continuing to undergo extensive changes on both domestic and international fronts. This fact is clear when we consider, for example, the extensive and profound impact of the explosive global growth of the Internet, or the rapid aging of Japan's population resulting from a decline in the birthrate. In such new situations, not only is the nature of social problems different from those in the past, but new ways of thinking about and addressing such problems are also required to respond to and resolve them.

The approach of policy management study¹ was set forth through the foundation of faculty of the same name by Keio University in 1990 as an academic and pragmatic challenge to address this situation. Ever since, we have continuously advanced a variety of research and practical activities on campus (Keio University Shonan Fujisawa Campus, or "SFC") where we have put our teachings into practice for the purpose of establishing the study of policy management (Okabe 2003b, Kaneko 2003, Umegaki 2003, Kagawa & Kojima 2003). The papers for Chapters 3 thru 9, which are collected in this volume, Policy Management Study: Methods and Practice of Problem Identification and Resolution (in Japanese), demonstrate very recent results in that respect. Concurrently with such concrete research and activities, we have worked to clarify, deepen and establish the concept itself of policy management study.

This chapter (Working Paper No. 125) and the following (Working Paper No. 126) present a bird's eye view of the results of our attempt to further clarify the concept through subsequent research, practice and debate, concerning the previously presented understanding of policy management study (Kojima & Okabe 2003). However, as is always the case where a new concept appears, the concept of policy management study is also burdened with the fate of changing and developing over time. Accordingly, it must be said that the understanding put forth in this chapter is in the end that which has been reached at the current point in time, and the understanding of other people involved may not be completely in accord with this understanding. So that I would like to mention in advance that this chapter substantially contains the author's personal opinion.

In Section 1, the traditional view of "policy" and its limitations are discussed, and reasons why a new approach of policy management study is required are presented. In Section 2, with traditional view of "policy" having undergone considerable change in recent years, the necessity of an understanding from the perspective of "social programs" rather

1) This study may also be expressed using other terms such as "comprehensive policy studies," "integrated policy studies," and so on, but for the purposes of this paper, the term "policy management study" shall be used.

than policy is demonstrated, resulting in the emphasis of the concept of “governance.” In Section 3, recent public policy administration is discussed since it has transformed in many respects resulting from considerable changes in recent years in the thought and method of implementation. Lastly, in Section 4, an explanation will be provided how policy management study differs from traditional policy studies, by comparing and contrasting the two. In the next chapter (Working Paper No. 126), policy management study will be addressed in somewhat more detail, and there will be a discussion of its theoretical foundation, characteristics of its methods, future issues to be considered and other matters.

1. Traditional View of “Policy” and Its Limitations

Before discussing the study of policy management, let’s first reconfirm the meaning of “policy.” Traditional policy has been part of state behavior related to the intrinsic function of a government (or state)², and, as will be pointed out below, matters termed to be policy are in many cases referred to as public policy. Next, the reasons will be discussed why policy in that sense has no choice but to significantly change in content, mode of administration and effectiveness, due to the changes in various conditions of recent years.

1-1 Traditional Understanding of the Government’s Role and Public Policy

The term “policy” generally refers to a course of action, scheme or procedure taken by a state (or a political party, policymaker, organization, or even an international body) in regard to a public issue. The subject matter in such case is a public issue rather than a private matter, and the aim is to resolve a certain problem (or to steer the matter in a desired direction, or to realize a desired situation). Also, the acting body in these instances is, in many cases, the government. Consequently, in the case of policy, the term almost always means public policy. In other words, a course of action or procedure for the government or other entity to carry out its primary function is generally known as public policy or simply policy.³

Since the functions of the government are multifaceted, public policy includes a variety of things. Consequently, to understand public policy, it is first necessary to set in order the basic functions of the government. Here, a table prepared by the World Bank

2) In the below, the term “government” and “state” will be used interchangeably.

3) Cases where policy is simply used ordinarily mean the public policy, as described. For commentary on the various theories, views on policy significance, participants in policy decisions, policy decision models, policy processes, the implementation and assessment of policy, see Miyagawa (2002).

Table 1 Functions of the Government

| | Addressing market failure | Improving equity |
|------------------------|--|---|
| Minimal functions | <i>Providing pure public goods:</i> <ul style="list-style-type: none"> • Defense • Law and order • Property rights • Macroeconomic management • Public health | <i>Protecting the poor:</i> <ul style="list-style-type: none"> • Antipoverty programs • Disaster relief |
| Intermediate functions | <i>Addressing externalities:</i> <ul style="list-style-type: none"> • Basic education • Environmental protection <i>Regulating monopoly:</i> <ul style="list-style-type: none"> • Utility regulation • Antitrust policy <i>Overcoming imperfect information:</i> <ul style="list-style-type: none"> • Insurance (health, life, pensions) • Financial regulation • Consumer protection | <i>Providing social insurance:</i> <ul style="list-style-type: none"> • Redistributive pensions • Family allowances • Unemployment insurance |
| Activist functions | <i>Coordinating private activity:</i> <ul style="list-style-type: none"> • Fostering markets • Cluster initiatives | <i>Redistribution:</i> <ul style="list-style-type: none"> • Asset redistribution |

(Note) World Bank (1997) Table 1.

is used as a tool for organizing an understanding of those functions. If we focus on the economic aspects of a government’s role, these functions are classified into two broad categories. One is “addressing market failure” or addressing a variety of problems that are not naturally solved through market mechanisms, and the other is “improving equity.”

The former category includes such basic functions as the provision of pure public goods (defense, maintenance of law and order, etc.) and addressing externalities⁴. Also included are eliminating concentrations of economic power that distort market functions, correcting imperfect or asymmetric information, and moreover activist intervention, such as coordinating or guiding activities of the private sector. On the other hand, the latter (improving equity) includes the guarantee of a minimum standard of living, the provision of social insurance such as unemployment insurance, and more activist intervention such as

4) Cost or benefit arising from any activity which does not accrue to the person or organization carrying on the activity.

redistribution of income.

(1) Traditional Understanding with Regard to Policy: Case of Economic Policy

If these traditional government functions are understood from the viewpoint of economic policy (this viewpoint has a general implication for many other fields), we have the following. Namely, economic policy can generally be defined as such an endeavor in some form or another by the central government or public sector (central bank, regional government, etc.) in response to an economy, which is changing by the minute, that leads to a more affluent or more comfortable situation for the public. In other words, economic policy is understood as the central government establishing some sort of economic variable (or multiple variables) as a policy goal and the act of the bringing the reality bearing on that variable closer to the goal (to the extent possible, that which can be expressed as a quantitative value). The three most fundamental goals of economic policy have traditionally been the efficient allocation of resources (efficiency), fair distribution of income (fairness), and stabilization of business activity and prices (stability). Other than these, goals such as economic growth, innovation, environmental protection, and amenity have been added over time.

The administration of economic policy in such a case can be expressed schematically as a chain of following situations. Namely (1) having knowledge on the part of the government to a considerable degree of the structure (model) in which the economy operates; (2) being able to clearly specify the means for implementing policy; (3) being able to establish criteria for evaluating policy effectiveness; and (4) acting of the government, on the basis of the above circumstances, to operate policy tools to maximize the evaluation criteria.

In such a case, some assumptions are tacitly made. First, “completeness” with regard to the government is assumed, in terms of holding adequate information (perfect information), the feasibility of objective judgment (prudence), and the controllability of the private sector from outside (exogeneity). Secondly, an assumption is made that the anticipated policy effect can be evaluated, according to some sort of criterion, whether it is desirable for society as a whole. For example, suppose that a certain economic change is produced which improves the economic welfare of some people without having any other individual suffer a loss. This change brought about by government policy, may be said a desirable change for society by applying a minimum value judgment (Pareto improvement)⁵. In other words, in the traditional understanding of economic policy, there are target variables

5) A situation where if the welfare of one of the members constituting a society is increased then the condition for at least one other

together with policy variables that are capable of manipulating the target variables. And the government is able to guide the intended direction of the whole economy (operation of the entire machine) with adequate precision by pulling on the policy variables (similar to a lever for operating a machine). Consequently, in traditional economic policy analysis, the implementation of policy is considered to be a technical issue or a problem of control engineering.

(2) Some remarks on Government Functions

Incidentally, three important remarks should be made on this role of the government. First, when we mention the role (function or activity) of the government, as shown in Table 1 previously, there is primarily considerable gradation in the functions themselves: the minimal functions, moderate functions and more activist functions among others. Even though we simply say “government functions,” comprised within that term are functions whose importance or characteristic properties are at an extremely high level as well as those that are not necessarily so. What is necessary to keep in mind in this regard is that the government’s minimal functions are indispensable irrespective of time or social development, and for this reason, there are also cases where enhancing functions of such an aspect would necessarily be preferable.

Since the late 1990s, a current of thought⁶, which some might call extreme, has gained clout temporarily. It has held that market mechanisms should be unilaterally emphasized and that market intervention by governments and international organizations should be minimized in all areas. However, this trend has had problems in that it does not fully appreciate that a strengthening of government functions is necessary in some cases (Fukuyama 2004). Consequently, in developing nations where there are governments incapable of fulfilling these fundamental functions, many problems (poverty, AIDS, narcotics, terrorism) have not been able to be addressed, and they have ended up instead aggravating these problems.

On the other hand, even in a case where reducing the power of the government is an important policy issue, for the government, construction of a solid infrastructure

person cannot avoid being worsened is referred to as Pareto optimum. As long as this sort of situation has not been reached, there is room for improvement (Pareto improvement), and economic policies for achieving such a situation will be rational. Although the realization of Pareto optimum is assuredly acceptable, there is too conservative an aspect in it in lacking positiveness when applied to policy theory. In order to overcome this shortcoming, a theoretical proposal was made in 1939 (Kaldor-Hicks compensation principle), and currently that mode of thinking is widely utilized in cost-benefit analysis.

6) In many cases public policies demanded of developing countries by international organizations in Washington, DC, USA, including the International Monetary Fund, are based on this kind of conception, and thus called the “Washington consensus.” See Footnote 13 of Chapter 2 (Okabe 2005), or Footnote 13 of Working Paper No.126.

(basic framework of society) has been its most important function in any country and at any time. Incidentally, recent comprehensive empirical studies conducted by the World Bank revealed that what is important for economic development is construction of a more general institutional framework as well as the endeavor of the government to that end, such as improvement of the legal system, enforcing contract and so on, rather than the extent of market development or what kind of system should be constructed (World Bank 1997, Demirguc-Kunt and Levine 2001).

Second, these government functions may differ when measured on a sort of temporal axis, such as the stage of economic and social development (including the government's regulatory ability), the extent to which market mechanisms are developed and how policy goals are prioritized. For instance, this may be easily understood in a case where income levels are comparatively low, such as Japan had at one time (late 1950s to early 1960s). At that time, raising income level (economic growth) was a primary function, in the view of the government, that should be given priority over other goals (for example, preventing environmental pollution) and for which it is easy to obtain a national consensus.

Third, the role of the government is not merely "What will the government do?" but it also comprises the issue of "How will it be done?" For example, in order to improve poverty in a developing nation, an indirect and long-term approach of increasing the people's capabilities would have a much greater effect in resolving the problem than the direct coping by the government of such a nation with receiving expanded aid or financing from developed nations and international organizations.⁷ In achieving the goal of poverty relief, this sort of recognition has become the mainstream in recent years. Accordingly we can say that a variety of policy options are feasible: the authority could perform functions so as to achieve a short-term, direct and visible goal, or to achieve a goal by relying on long-term, indirect means (adopting the policy of "sure and steady").

The above-mentioned first and second points indicate the reliance of government functions on time period, and the third point indicates that the method of policy implementation can be selected from a variety of options. Therefore, it is necessary to recognize that government functions, or public policy, is not a fixed concept in the scope, objective and manner of administration, and varies depending on conditions such as the social environment at given point in time.

That is not all. As mentioned above, in traditional public policy thought, the economic problems of contemporary society have been understood to be basically resolved by the working of market mechanisms, so that government intervention (government

7) In this volume, see Okabe (2005, 2-3) in Chapter 2, Umegaki (2005) in Chapter 4, and Shirai (2005) in Chapter 7.

administration) or social decision-making through political process is necessary only for problems that are not easily resolved by such mechanisms. This was the traditional understanding regarding the people and the government. In other words, in the view of public policy, there is a clear conceptual division between the actor implementing policy (the government) and the object that is the target of the policy (the private sector). Metaphorically speaking, we may say that when the government exogenously operates the handle (lever) of public policy, the behavior of the private sector is a passive responder in accord with that.

To summarize, we need to understand that not only does the content of the public policy itself change when various conditions are altered, but the relationship between the government and the private sector and consequently, the mode of public policy and its effectiveness, also change. Then, in the next section, we will take a look at the various factors that have brought about a change in public policy in recent years.

1-2 Reasons Necessitating Alteration of the Concept of “Policy”

Two kinds of forces have driven the traditional concept of “policy” to alter.

(1) Impact of the IT Revolution

One is the revolution in information and communication technology (also known as “ICT” or simply “IT”). The IT revolution refers first to the transformation in information and communication media from conventional paper to an electronic medium (based on digital signals), and second to the formation of a global network known as the Internet. This kind of IT revolution or innovation in media has dramatically reduced the cost of gathering, processing and transmitting information. The results have brought about a dynamic expansion in the range within which information can be distributed and the speed with which it may be shared.

The development of this kind of new media technology has dramatically increased information available for use by the individual and has been a factor in empowering and lifting the capability of an individual to improve his or her situation. This force has been compelling organization such as commercial companies and other entities to reform its structure drastically. Why has that been so? The answer is relatively easy if we go back to a fundamental question “Why do companies exist?” and think about the reason.

The standard theory explaining the existence of a company (a firm) rely on the transaction costs⁸. When we want to procure a certain good or service, we first search

8) Presented in a 1937 paper by Ronald Coase, and was subsequently developed by Williamson and others. See, for example,

for relevant information, negotiate when we have found a trading partner, enter into a contract for the transaction and then secure fulfillment of the contract. And if the good or service turns out not as contracted, it becomes necessary to take appropriate actions. This transaction process it inevitably involves a series of labor, time and monetary costs. These are in the end all costs that accompany the operation of an entire economic system, and they are in the aggregate known as “transaction costs.” If many individuals, each demanding a specific good or service, entered into contracts with each other for the provision of labor, the number of contracts that would have to be agreed upon as well as the contract terms that would have to be agreed to, including pricing, would be astronomically high, making the overall transaction cost extremely high. Therefore, rather than having an individual execute transactions through such individual contracts, the information processing capacity of each can be improved by forming groups and handling these situations as an organization. In such a case, practicality dictates that an internal hierarchical organization be formed with regard to information and decision-making. This is the reason for the existence of companies as viewed according to the theory of transaction costs.

As the IT revolution has lowered transaction costs, the efficiency to form hierarchical organizations as in the conventional model has rapidly decreased. As a result, powerful pressure has been generated to decentralize the authority and the information flow in an organization and to flatten the vertical structure of organizations. Similarly, it is easy to understand that there are less reasons for maintaining a solid social structure where information is concentrated in the government and the government exclusively implements policy. The reason for the expanded role of NPOs, which will be discussed later, is thought to be due to this sort of change in the environment for information processing throughout society. In this way, the development of technology (in the form of instruments and media) ends up fundamentally altering the course of organizations, society, institutions and life⁹.

Also, knowledge and information that had previously been accumulated and utilized only among specialists has now been released from the narrow circle and gradually become a stock of knowledge that can be used by mankind on this planet regardless of place and time. This sort of dramatic change in the information environment has not merely impacted the nature of organizations, such as companies and other groups, but is continuing to fundamentally transform the nature of how human society is to be organized, including the relationship between the government and the people. In other words, we are no longer able to accurately understand the contemporary society by simply applying the conventional and

Williamson (1996).

9) How strong and extensive this pressure has been is discussed in detail by Kokuryo (2005) in Chapter 4 of this volume.

simple model of the vertical relationship between the government and the people.

On the other hand, the growth of the Internet has rendered national boundaries meaningless in both the circulation of information and economic transactions. The globalization in these aspects is now demanding to fundamentally reconsider the traditional concept of the government and the nature of all sorts of public policy attributed to the government. If viewed from an international perspective, economic activity is now liberated from the boundary of the nation-government and national economy, and there has been an increasing tendency (international competition of institutions) for economic activity to be located where the social and economic institution is most advantageous in which to operate. Also, regional integration, market globalization and other new pressures are strongly affecting the terms of transaction, and pressing the government to change its role. Under these sorts of new conditions developing nationally and internationally, a reassessment of the whole concept of traditional public policy and its effectiveness is inevitable. Under these circumstances, reexamination is also required in the meaning of various social institutions, legal frameworks, and the workings of the government.

(2) “Government Failure” and the Breakdown of Assumptions Concerning Government Behavior

One factor that is currently driving a change in policy is the increased empirical and academic understanding of the limitation of public policy content and administration. In several areas where the government had traditionally been regarded as having a major role (for example, areas relevant to human services, such as basic education and health), it has gradually become clear that government policies have not produced a sufficient outcome particularly in a qualitative aspect. And accompanying this, the participation of the private sector (NPOs and other similar bodies) has increased. Also, in traditional public policy, there has been not a few instances of clear failure; for example, delays in reforming the system of Fiscal Investment and Loan Program, the failure to dispose of nonperforming loans of financial institutions in a timely manner, etc. The result has been, in regard to these areas, to exhibit questions as to whether or not it is really reasonable to resolve problems through government engagement alone. In fact, these areas do not belong to intrinsic government roles and are only subsidiary matters as indicated in the bottom section of the aforementioned Table 1. As a result, a recognition has become common that government involvement should be pulled back in these areas. Also, there has been an increased recognition that there are areas in which non-government sector can provide higher quality

services and more efficiently than the government.

On the one hand, there are considerable difficulties, as pointed out earlier, with the assumptions themselves concerning government administration of policy: namely the assumptions of perfect information or informational superiority, prudence (virtuousness of those in charge of policy), exogeneity from the private sector, among others. Accordingly, it is no wonder that a variety of theoretical and empirical researches have demonstrated that the traditional understanding of state administration of public policy is in need of major revision.

There are many examples. First, since the IT revolution undermined the state's information superiority, it has forced a reconsideration of the validity of public policies, such as industrial policy and bank supervision policy, which had been formed entirely on such assumptions. The result of the IT revolution has been that private companies and banks steadily increased the sophistication and complexity of the products and services they provide, for example, new financial products and financial techniques that make extensive use of information technology, and that the activities of companies have also altered. So that we can now hardly say that bureaucrats hold more appropriate information than the private sector. The result has been a sharpening of asymmetry of information between the policy (regulatory) authorities and banks. Consequently, the monitoring body (authority) lapsed into a situation of having information that was inferior to that held by the subjects being monitored (private companies, banks, etc.). Thus, a fundamental question has been raised on the capacity, as well as the effectiveness and fairness, of authorities to monitor the private sector as in the past.

Second, there has been an increased recognition that public policy should be viewed as an outcome of a political decision-making process where a variety of interests intertwine in a democratic and bureaucratic system and that it is implemented in the same manner, rather than being formulated and administered by fair and impartial wise persons. This view rests on the public choice model and can be characterized as the theory of non-market decision-making. Put differently, public policy may be understood as a relationship where the public entrusts the implementation of policy to those in charge of the policy (principal-agent relationship), so that there is no guarantee that the most appropriate policy for the public will be implemented as long as the possibility exists that the fiduciaries of this function may give priority to their own interests. This kind of understanding (using the agency model) has also gained popular acceptance as one point of view. These views, while differing in their theoretical foundation, can be said to show the nature and the limitations of the institutions and the administration of public policy. Although the action of the government comes

originally from correcting “failure of the market,” it is necessary in reality to recognize that the “failure of the government” is also unavoidable.

Third, it has gradually become evident that there are also difficulties with the assumption that the government is independent of the private sector and its policy behavior is able to guide the private sector in the intended direction (exogeneity of state behavior). In reality, there have been examples that violate this assumption.

For instance, the regulation to maintain the stability of the financial system, so-called BIS capital adequacy requirement¹⁰ which was originally introduced in 1988, is a case in point. When undertaking subsequent revisions, national and international regulatory authorities did not first present a final rule book, but they first presented a “consultative paper” internationally and nationally in many nations to the concerned private sectors, and requested opinions from them. This is partly because the content of the requirement has become more sophisticated and specialized requiring technical clarification and inputs by experts in the financial industry. Such an interaction has proceeded successively throughout the private sector in many nations and has been implemented in a highly transparent manner. Such a process has facilitated to coordinate various parties concerned and revise the requirement in detail and ended up to formalize a new international standard. This is known as the New BIS Requirements or “Basel II,” and is to be applied in many countries starting in 2006. In this case, the state does not entirely work exogenously, but has become an endogenous entity that negotiates with the private sector. Accordingly, the New BIS Requirements can be said to be a policy¹¹ produced jointly by public and private sectors.

In domestic spheres also, private nonprofit organizations (NPO), rather than governments, have gradually tended to complement or substitute public policy, particularly in regard to human services, as will be discussed later. Given such a reality, it is becoming increasingly difficult to properly understand the behavior of these organizations in the traditional concept of economics where the private sector is understood to be a set of entities maximizing their private utility or profit. Also, it has gradually become harder to distinctly separate the actions of both the market and the public administration in regard to the resolution of social problems. Thus, traditional dichotomy to understand the society is simple and straightforward, but there are serious questions as to its validity.

Furthermore, recent experience and theoretical analysis have confirmed that the

10) This regulation, which stipulates an international standard of capital adequacy requirement of banks, is commonly known as the Basel Capital Accord and has been adopted by more than 100 nations.

11) The policy formation process regarding this bank supervision can be treated as a two-stage game: international negotiation and consensus building among all nations (Basel process), and subsequent domestic negotiation and consensus building between the policy authority and the private financial institutions in each nation (Okabe 2003a).

effect of a policy that the government announces and tries to implement (or whether a policy effect can be expected at all) depends crucially on the degree to which the private sector has confidence in the behavior of the government. That is, administration to ensure the effect of the policy is no longer easy: there exist situations where a policy, which had been considered desirable at the time of announcement, becomes no longer the most appropriate policy at the time when it is actually implemented. A contradiction emerges once we introduce a chronological perspective in policy planning and implementation. This contradiction is referred to as an issue of time inconsistency¹²).

For instance, let's consider a case where the financial authority declares as follows. "Even if the operation of a major bank fails, the authority will never save the bank. It is because the bailout would not only run contrary to maintaining managerial efficiency through competition but would be burdening on the public by using tax revenue." In reality, however, we frequently observe situations where such institutions are saved by an infusion of tax revenue in order to stave off a widespread impact if the operation of a major bank were to actually fail. This policy is known as the "Too big to fail" policy where insolvency cannot be allowed because the scale of the damage is too great. The implementation of this kind of "relief" could be in fact one of several optimal policies if it is redesigned based on the assumption of a new situation where an operational failure has actually occurred and there is concern about its widespread effect. There is an important point in this. Let us assume that the authority has subsequently declared: "The rescue of the major bank this time was entirely an exception, and in the future such a treatment will never be made." This announcement will probably have almost no effect. The reason is that the general public (banks) will anticipate the government's ultimate behavior, leaning from the past experience, and act accordingly regardless of what the government's declaration of its intent. The result will be a slackening in managerial ethics (moral hazard) at banks, so it is highly possible that managerial efficiency through competition will no longer function effectively. In other words, the expectation itself held by the private sector regarding the policy behavior of the government will govern the actual policy effect. This implies the importance of expectations for effective policy.

To summarize, we have no choice but to abandon the traditional understanding of policy, which is based on a series of assumptions¹³ that society is comprised of two kinds of entities, the general public and the government, and that the policy authority has not only

12) This concept was introduced in a 1977 paper by Professors Kydland and Prescott. Incidentally, both professors recently received the Nobel Prize in Economics (2004) for a series of achievements on these researches.

13) This kind of assumption in public policy theory has been called the Harvey Road presumption, after the name of a road in the birthplace of the economist J. M. Keynes. See, for example Asako (2000).

correct knowledge about the economic structure but also the capability and incentive to undertake policy intervention with appropriate timing.

2. Innovative View of “Policy”: Social Programs

Public policy is a government measure or action intended to respond to a variety of problems and issues in human society or to devise countermeasures in advance so that a problem does not occur. The scope, content, objective, and method of administration vary depending on various conditions, such as the social environment or information technology, as stated in 1-1. In recent years (particularly, the last 10 to 15 years), conditions giving rise to such changes have increased markedly (see the preceding 1-2). In this section, we discuss what the “policy” is and should be under the new conditions in recent years, with a focus on the scope, the methods of implementation, and the engaging entities of the policy.

2-1 Changing of the Scope and Content of Policy

Public policy in the traditional sense, as one of government functions, has tended to narrow its scope in recent years (see Table 1 above). Also, changes have been seen in the content of policy in recent years. For example, in the case of government fiscal policy, traditionally the debate has centered on the level of discretion of various fiscal indicators, such as tax rates, subsidies for specially designated industries, etc. In recent years, however, the major policy issue has been not on what level policy variables are to be fixed, but on the question of how institutions or rules pertaining to government finance (for example, the establishment of medium-term numerical target values concerning deficit ratio reduction) should be established has become the more important and central. That is, the issue has shifted to designing institutions. Since public policy extends to vast areas, it is difficult to make a comprehensive summary all the issues. Here, suffice it to take a brief look at a few examples from some representative policy areas.

(1) Institutional Design or Institution-Building at the Core of Policy Discourse

First, let us take a look at macroeconomic policy. In monetary policy, the central concern of policy debate has traditionally been with the question of what level of interest rate or money supply should be for a given economic situation. However, in monetary policy discussions here and abroad over the last ten years, the focus of the debate has shifted, from that on numerical levels of interest rate or money supply, to that on desirable institution in

the sense of what sort of institutional arrangement should best be made for attaining the final goals of the policy. One example is the proposal, called inflation targeting, in which the central bank fixes and announces a target value (or target range) for the price increase rate, and manipulates the interest rate and money supply freely in order to attain the target. If this scheme is to be adopted, then there stems a discussion of how such a mechanism and institutions should effectively be established. One issue in this regard relates to the obligation on the part of the central bank to provide an adequate explanation (accountability) to the public, and the other the establishment to guarantee independence of the central bank from the government in pursuing the policy target¹⁴.

Also, with regard to bank supervision policies, whose policy target is to maintain stability of the financial system, there has been a lively debate starting in the early 1990s in the United States about the creation of rules for administration of such a policy. And soon after the debate, in both academic and policy circles, a host of new rules were introduced. In Japan also, since 1998, a new rule of prudential regulation of banks called Prompt Corrective Action, based upon a bank's capital adequacy ratio¹⁵, have been introduced, and are now playing a leading role in place of the traditional discretionary policies.

In regard to government fiscal policies, we see a similar trend in the debate in the major nations. That is, there has been more emphasis on how an institution should be designed to maintain fiscal discipline over the long-term, rather than a policy discretion concerning annual fiscal revenue and expenditures. For example, in recent years in the European Union, a heated debate has been going on among the member nations and organizations about the strict application or treaty revision of "The Stability and Growth Pact" (concluded in 1997) for the purpose of strengthening and clarifying procedures to observe fiscal discipline by member nations. Also, in Japan, which continues to have massive budget deficits, institutional arrangements that reduce structural deficits (arrangements that ensure transparency and the establishment of numerical target values over the medium and long-term with regard to deficit ratios) have become the current major contention, along with the debates over income and expenditures for the immediate fiscal year.

In public policies other than macro economic policies, there is a similar trend. In the case of environmental policy, for instance, a market for emissions trading¹⁶ was already

14) These issues have been discussed globally, and in Japan also, and the Bank of Japan Law was completely revised in 1997, strengthening the Bank of Japan's independence from the government.

15) For a more detailed discussion, see Okabe (1999, Chapter 12).

16) This arrangement allocates to companies and other entities a fixed allowed discharge for the amount of greenhouse gases such as carbon dioxide, and allows any surplus or shortage in the emissions within the scope of the allocated amount to be traded on the market. It is regarded as having advantages, such as maximum overall emissions can securely be attained, and the social cost of emission reductions can be trimmed back.

established in the United Kingdom (in 2001) or consideration is underway for setting it up in the major nations, including Japan. And the problem has been tackled by these new schemes along with other traditional policy devices of direct regulation (restriction and prohibition) and fiscal measures (surcharge or subsidy). The establishment of this kind of institution or new market can be said to be a policy having a new character in that it attempts to respond to a public concern by utilizing market mechanisms (state spearheading an institutional arrangement for that purpose) rather than the government directly utilizing a policy device in the traditional sense (legal measures or administrative authority) to solve the issue. Also, the policy for privatization of postal services in Japan (enacted in 2005) is a fundamental change in the policy philosophy now entrusting to market mechanisms those financial activities for which the government has traditionally shouldered responsibility. This movement is grounded on the same policy ideas as mentioned above.

Another example is the policy concerning nursing care for the elderly. In this case, reform of the relevant institutions is currently (2005) being attempted by the government. And this vision calls for the introduction of an institution in which municipalities and companies providing nursing care services in the private sector (managerial companies) are more systematically linked in order to improve the quality of the provision of these services.¹⁷ In other words, the policy emphasis is not on a mere monetary response but aims at improvement and construction of necessary institutions.

If we cite a further example of an international issue of development in developing nations, the new conventional wisdom in recent years for development (more generally for the social development) gradually emphasizes the importance of institutional quality, in addition to government capacity and good governance (World Bank 1997).

As is clear from examples given above, the core of public policy in recent years has become institutional design or institution-building rather than the mere operation of policy variables. So, why has the content of public policy undergone such a transformation recently?

(2) Reasons Priority Shifted to Institution-Building

Recent trend in public policy discussion has shifted from the view that policies should be implemented in accordance with developments in society to the view that design or construction of relevant institutions should be emphasized. There are a number of reasons for this change.

17) An example is the establishment of the “Regional Comprehensive Support Center” which is participated by many entities including municipalities and private management corporations. For details, see the website of the Ministry of Health, Labour and Welfare at <http://www.mhlw.go.jp/shingi/2005/02/s0209-8f.html>

First, in the case of macroeconomic policy, that recent view is closely tied to the fact that rules (in other words, institutions) had been given more emphasis in the traditional debate of “rule versus discretion.” That is to say, if policy is implemented in a discretionary manner in response to society’s current situations, there is a high possibility of generating the following problems:

- (1) the appropriate timing of policy action may be lost (time lag problem), since a comparatively long time is required for each stage of situational recognition, consideration of the necessary means, and implementation of policy means;
- (2) a discretionary response may amplify the economic fluctuation (issue of imperfect information), since we have not yet perfectly understood the mechanisms of economic; and
- (3) the timing and effectiveness of policy implementation may be impaired (issue of distortions due to political factors), since discretionary measures inevitably involve political factors for the decision.

As a result, it is considered more desirable to implement policies according to announced fixed rules than to apply discretionary measures. The introduction of rules means that the actions of the policy authority (central bank or fiscal authority) will be restricted on the one hand, but on the other hand, transparency and predictability of the policy implementation will increase. In other words, fixed rules have the advantage of decreasing uncertainty in regard to the necessity and the required policy response. It is important to recognize this aspect of an institution or a rule.

Next, when implementing policies that promote the application of market mechanisms (for example, the case of introducing a system for emissions trading, as mentioned above), the measure not only guarantees overall efficiency by market discipline but is usually capable to respond to changing social conditions more flexibly than an administrative government response. Let us take up other case, where a nonprofit organization (NPO) or a similar nongovernmental organization (NGO) is introduced, which do not belong to the traditional private sector entities of either business firms or individuals, in order to solve a social problem (for example, for reforming the nursing care system as mentioned above). If such an “intermediary organization” is utilized, a problem would likely be handled more appropriately owing to such organization’s informational superiority. It would mean a better solution than to choose from among alternative approaches derived from the dichotomy of “government or citizen” or “public or private.”

All of the above three measures can be understood as belonging to public policy in the broad sense with each having elements of (1) institution-building, (2) further

utilization of market functions, and (3) making use of intermediary organizations (NPOs or NGOs). Why are these policies can be said rational? Next, we will try to answer this question theoretically by making use of recently developed theories: economic analysis of information, institutional analysis, public policy theory, and so on. Here the two main questions are: what are the fundamental functions of an “institution”? And how various information should efficiently be processed for a society?

(3) Theoretical Analysis (1): Diminished Uncertainty Due to Institution-Building

First, an institution generally refers to the established rules, procedures and mechanisms in the course of administering a state, society, group, and so forth. It includes two categories. One is formal institution having a fully developed form, such as laws, judicial precedents, various regulations, and so on. They are institutions in the narrow sense. The other is the informal type not having a defined form, such as customs and practices, standards and norms, implicit codes of conduct, taboos, traditions, and so forth. In this paper, let us define an institution to include these two categories, and treat institutions in the broad sense referring to “institutions as well as customs and practices.” Thus defined, institutions may be understood as being a constraint that man has deliberately created, and functions to regulate or restrict the way how humans interact with each other politically, economically and socially.

When institutions are understood in this manner, they may be said to be something that influences people’s way of looking at things and the decision making. It provides a framework for incentives (behavior inducement) in the interaction among people. Therefore, the nature of an institution and how it alters significantly affects the performance of a society and its change. Conversely, society and its changes have a considerable impact on what an institution is and ought to be. Accordingly, an institution has a close connection with the developments of human society (for example, economic performance)¹⁸, and it can be said to be natural that public policy, which attempts to resolve problems in human society, has gradually come to emphasize the design and building of institutions.

What is the function of an institution? Let us consider this subject from scratch. When a man attempts to solve a problem, he has no choice but to always behave upon

18) The understanding regarding institutions here is in a large part based upon North (1990) and Williamson (1996), who provided representative and systematic analysis of the subject in recent years. Historically, the idea that institutions play an important role for the decision-making of individuals and accordingly for the overall economy became quite fashionable in the beginning of the twentieth century in the United States as a criticism against classical economics which focused on market mechanisms. The scholars of the institutional school include, among others, Thorstein Veblen and Wesley Mitchell. Recent researches in this area by Douglass North, who received the Nobel Prize in Economics, can be understood as a modern restoration of that school. There is a similar and related concept to institutions, namely organization, but it needs to be separated from institutions.

incomplete information. Therefore, uncertainty will always accompany the results and the assessment of behavior. The reason this uncertainty is inevitable is that resolving a problem is itself intrinsically complex and that there is a limit to man's ability to process information even if much information were available. Under such circumstances, an institution, in the sense as stated above, would provide a framework for people's daily behavior. In other words, the institution would help to predict more accurately what kind of behavior would produce what kind of outcome. The result is that political and economic interaction or exchanges of goods and services among people are made easier, and the establishment of a stable structure reduces uncertainty. Thus, institution can be said to exist due to the uncertainty accompanying human interaction, and to exist (or is intentionally created) in order to encounter and reduce uncertainty in human interaction. The greatest function of institution may be said to reduce uncertainty in human society.

If we use the terminology of information economics or contract theory, an institution is understood as having the function of lowering information costs (cost associated with knowing about another party's actual situation), monitoring costs (cost of monitoring the behavior of another party), and enforcement costs (cost of imposing sanctions when another party breaches a promise) that arise when human beings interact. On the other hand, an institution also creates an incentive structure in human interaction. If this line of thought is extended, "organizations" can be understood as created in order to better utilize the various opportunities provided within a certain institutional structure. Consequently, we can understand that change or development of an institution naturally alters the nature of the organization¹⁹.

It is worthwhile to mention incidentally that when we try to build an institution, it is often less risky and more practical to utilize a spontaneous order such as customary law or generally accepted customs rather than to establish a hard positive law such as the statutes (Ikeda 2004, Shleifer 2002). The reason is this: if an attempt is made to enact a statute, firstly it inevitably involves a political decision-making process, and secondly particularly in the case of legislation initiated by the bureaucracy (as in making laws pertaining to specific industries) there will be broader scope of administrative discretion, leading to the situation where a government agency exercise in effect judicial functions

"Practice" and the formation of customs or institutions based upon practices is an important component of policy management study²⁰. The above analysis hopefully provides its theoretical rationale to it.

19) The new establishment of an organization called "Regional Comprehensive Support Centers" in reforming the nursing care system (Footnote 17) is an example in this regard.

20) Elements comprising policy management study are explained in Okabe (2005, Section 3).

(4) Theoretical Analysis (2): Facilitating Efficient Processing of Information

With the reasons having been explained above in regard to why policies are prioritizing institution-building, how may we next understand the prominence of both the application of market functions ((2) in the last paragraph of the foregoing 2-1 (2)) and the application of intermediate organizations such as NPOs ((3) in the same paragraph)? What is common to these two cases is that efficient processing of information is the primary factor.

The smooth functioning of economic activity in society as a whole requires diverse information being identified, evaluated and utilized. Seen from such a perspective, the market can be understood as being an information processing system more than anything else.²¹ In other words, rather than streamlining the static distribution of resources, the greatest distinguishing feature of market mechanisms is that “knowledge about circumstance of a specific time and place,” which each individual holds, may be utilized in a decentralized fashion without being tabulated by a statistical agency. Although it is theoretically possible for an authority to tabulate and reconcile information concerning incomes, such work is prohibitively complex and furthermore consumers and factories lack incentive to announce correct information. Consequently, we cannot rely on such types of centrally controlled mechanisms. On the other hand, market mechanisms can be said to be a system that breaks down and solves computationally complex problems as a collection of simpler problems for individuals. It is a structure capable of decentralized utilization of knowledge and information available in a society.

Incidentally, the IT revolution of recent years has dramatically lowered the cost of acquiring, saving, processing and sharing information for individual private entities (individuals and companies). Accordingly this has on the one hand strengthened the incentive to personally acquire, save, process, and share a variety of information, and on the other hand it has decreased the necessity that information be concentrated in the government (information being indispensable as a basis for policy behavior). The logic of applying market functions that regard the decentralized utilization of information as essential can be construed as a response to this kind of change in the information environment.

With regard to the increased use of intermediate organizations such as NPOs, one

21) The description below is based mainly on the account of Ikeda (1997, Chapter 1), which appropriately summarized Friedrich von Hayek (1945 thesis: “The Use of Knowledge in Society”). Ikeda (1997) keenly pointed out, at a comparatively early stage, that the true nature of the recent information and communication technology (ICT) revolution was continuing to fundamentally change the distribution and availability of information in this manner. And he pointed out also that the result was a precursor of the debate on the continuing revolutionary changes occurring to the state of organizations and society. His recent works (Ikeda 2004, 2005) have further deepened that perspective.

reason is that the demand for human services has increased along with the ageing of the population. And the other reason is that “market failure” has been inherent in the quality aspects of such service provision and there is a great need to address it. Another lesser aspect is that because NPOs and other intermediate organizations are comparatively closer to individual private entities than the government, with respect to incentives for providing information and efficiency in utilizing information, it may be construed that utilizing such organizations is more practical than direct participation by the government to address human serviced-related concerns

2-2 From Public Policy to Social Programs

As is clear from the above, society and the information environment have undergone significant change, so that there is a limitation in the traditional concept of policy which regards the policy as comprised of decision-making and the implementation by a central government utilizing its legal and administrative authority. That kind of policy cannot effectively resolve social problems any more. Also, the validity of the new understanding of policy is supported by theoretical development in a variety of social sciences in recent years, including the economic theory of information.

Well then, how should the understanding of policy (or public policy) be reworked? In this paper, I would like to use the term “social program”²² in the following discussion, in place of the traditional term “policy”. Here, social program shall mean “a countermeasure possessing a cohesiveness that is planned (devised, drawn up or designed) in order to resolve a problem which has happened in society or to improve a social condition.” In the expression of traditional policy, there have been many instances where the implementing main entity is almost always suggested to be the central government (or an official body such as a central bank or regional government). But now, the extensive participation by entities other than the government including NPOs and other intermediate entities in addition to private entities has been required in clarifying a variety of social problems and in finding a solution. Accordingly, in my judgment, replacing the term policy by a new expression of social program, this necessity can be clearly expressed. Because the entities or organizations concerned with social programs are diversified, a separate concept (understood as governance) instead of traditional command and control has also become essential to the process of implementation (to be explained in detail in the following Section 2-3 (3)).

22) This term was used regarding policy assessments by Rossi, Lipsey, and Freeman (2004), and their meaning is further broadened here.

2-3 Diversification of Participating Entities and Change in Recognition of the Policy Process

When understanding the resolution of social problems from the perspective of the implementation of “social programs,” a recognition differing from traditional “policy” in several respects becomes necessary. Of these, three aspects are particularly important: (1) the increasing importance of nonprofit organizations (NPOs); (2) necessity of a new recognition concerning the relationship among the concerned entities in the problem-solving process (perspective of governance); and (3) reform of methods of administration of policy or social programs. I would like to take a look at these three one at a time.

(1) Increasing Importance of NPOs

Non-profit organizations (NPO) or non-governmental organizations (NGO) are organizations that have increased their importance in recent years. These are generally called citizen action groups. Although the necessary conditions for these organizations have rarely been stipulated uniformly, it is generally understood that the basic characteristics include that: (1) they are duly organized; (2) they are private (non-government); (3) they are not-for-profit; (4) they are formed voluntarily; (5) there is the absence of a proprietor (stockholder, etc.) to apply systematic discipline to the organization so they are predicated on self-governance; (6) there is no necessity for profit-sharing; (7) preferential tax treatment is often accorded.²³

Essentially NPO and NGO do not differ in regard to these aspects. But today (particularly in Japan) it often appears that these terms are used to mean a slight different organization in nature. NGO signifies a group undertaking development or aid transcending national boundaries (nonprofit organizations operating internationally), while NPO refers to a group undertaking welfare, educational, environmental, village revitalization or other activity within the boundaries of a country (domestic nonprofit organizations). Also, there are several different cases depending on the solidity of an organization or the extent of the activity.

For example, when the structure is informal, such as a gathering of interested people, they are called volunteer groups; but when they develop organizationally more by, say, setting up a steering committee and an office, they could become an NPO or NGO in both name and substance. Also, there are cases where a “common” (a shared space of relationship and information) or a community is created by individuals or organizations in order to solve some sort of social problem, or where individuals or organizations voluntarily

23) These aspects are consolidated by the author relying on Glaeser (2003) and other relevant papers.

form a community of their own accord and mutually observe the rules they create (Kaneko 2004). They may be considered to be an NPO or NGO in a broad sense, since they are also volunteer organizations in nature.

The feature of recent years is that there has been an increasing trend in the number of groups having the character of an NPO or NGO²⁴. One motive underlying the reason for this is the implementation in 1998 of the Law to Promote Specified Nonprofit Activities (NPO Law). However, more fundamentally, this increase is due to the following factors. (1) The inability of both the public and private sectors, as stated above, to independently respond adequately in terms of quality in the provision of human services or public goods, in such areas as environmental protection and quality improvement of welfare. (2) The “government failure” being manifested in the international arena where official development aid (ODA) has not reached its ultimate recipients, and the necessity has increased to rectify this with a new structure (complement comprised of both the public and private sectors). Accordingly, areas where NPOs play an important role are not those where private commercial enterprises function well (for instance, production of consumer goods). But it is those where “government failure” occurs easily, such as medical care, elderly welfare services, basic education (including universities as an intermediate support organization), culture, and religion, and those areas where market mechanisms are comparatively difficult to function. These areas have become the main focus of their activities.

(2) Structural and Behavioral Characteristics of NPOs

When NPOs are compared to a variety of other organizations, what are their distinguishing organizational features? Who, properly speaking, is the stakeholder (interested party)? What kind of standards of conduct do NPOs have and what fulfills the function of providing discipline? How does the organization arrive at its final behavior (organizational governance)? How can efficient performance actually be assessed? What sort of mechanism is there to improve organizational governance? How should the state participate in policy?

With regard to NPOs, there are a great many of these kinds of theoretical and empirical issues to be considered. However, almost no research providing systematic answers

24) The total number of nonprofit foundations (NPO corporations) has declined somewhat in the last five or six years (25,825 corporations were licensed as of 2003) reflecting streamlining attributed to administrative reforms, but the number (published by the Cabinet Office) of new applications received for establishing an NPO corporation has shown an increasing trend in recent years as follows (figures are according to the Ministry of Public Management, Home Affairs, Posts and Telecommunications' White Paper on Nonprofit Foundations and the Ministry's website).

| | | | | | |
|---------------------------------|------|------|------|------|------|
| Fiscal Year | 1999 | 2000 | 2001 | 2002 | 2003 |
| Number of applications received | 139 | 208 | 330 | 448 | 455 |

Table 2 Three Representative Entities Constituting Society and their Behavioral Characteristics

| Entity | Handling of information | Standard of conduct | Characteristics of performance |
|---|--|--|---|
| State | <ul style="list-style-type: none"> Needs to acquire and integrate information from the private sector | <ul style="list-style-type: none"> Law, administrative authority | <ul style="list-style-type: none"> The problem arising from agency relationship (inefficiency) is inescapable, since the government is an citizen-delegated entity |
| NPO/NGOs | <ul style="list-style-type: none"> Intermediate and diverse form of responding and handling information | <ul style="list-style-type: none"> Diverse behavioral motivations coexist Credibility and reputation are important | <ul style="list-style-type: none"> There are both cases of a highly efficient organization and an inadequate functioning due to weak governance |
| Private entities in the market (company and individual) | <ul style="list-style-type: none"> Information is held in a decentralized manner by individual entities and no need for integrating the information | <ul style="list-style-type: none"> Pursuit of profit or satisfaction | <ul style="list-style-type: none"> Efficiency is maintained by the operation of market mechanisms The case of market failure also exist |

in these regards has been seen, because their increase in importance has been comparatively recent coupled with the fact that their organizational forms and areas of concerned are diverse. Here, I will put forth one arrangement for the purpose of assuming a starting point.

Table 2 is a conceptualization of three representative entities constituting society and their behavioral characteristics. First, these social organizations can be distinguished from the standpoint of how their structure gathers and processes all information. Looking at the way in which information is handled first for the state, the implementation of policy initially becomes possible through the acquisition and integration of information (various data necessary for administration) from the private sector. In comparison, private entities acting in the market (companies and individuals) do not need to integrate information because individual entities each hold diversified primary source information, all of which is reflected in market transaction (specifically, as price formation). On the other hand, it can be understood that NPO/NGOs are ranked midway between the state and private market entities with respect to the handling of information because they do not necessarily act in accordance with market mechanisms. Next, as to standards of conduct, government has its foundation in law and administrative authority, while for private entities participating in the

market the pursuit of profit (companies) or the pursuit of satisfaction (individuals) are the motivation for the behavior. On the other hand, in the case of NPO/NGOs, motivations for behavior are diverse both as an organization and as each stakeholder involved in it. Also, in the case of NPO/NGOs their social recognition itself becomes important, since, being different from private companies, they lack an owner (stockholder) and the disciplinary coming from the owner. Consequently, the maintenance and enhancement of credibility or reputation become the important standard of conduct for them, since they are different from private commercial companies and individuals.

Assuming this kind of organizational characteristic and the standard of conduct, the performance characteristics of these three entities can be derived as follows. First, because the state is an entity to which various functions have been delegated by the citizens, the inefficiency coming from the so-called agency relationship²⁵ is unavoidable. On the other hand, private commercial entities can be expected to maintain efficiency due to the competitive forces of market mechanisms. We need to recognize, however, that there are also situations where market mechanisms do not operate (market failure).

In contrast, it is difficult to articulate in advance what the performance of NPO/NGOs will be, and it ultimately becomes a matter of empirical issue. Although such researches are scarce at present, a recent prominent research in the United States (Glaeser 2003) has reported a very interesting result. According to the study, the NPOs with good organizational governance (namely, the cases where competition is working for employees, customers, and donors) have statistically shown efficiency equivalent to commercial companies. On the other hand, the NPOs with large endowments and weak governance have shown less efficiency, since the directors of the organization tend to increase their own profit rather than the profit of the donors, customers and society.

Traditionally, the administration and operation of organizations has been classified broadly into two kinds: one is “public administration” which is regarded as the government’s administrative activities, and the other is “business administration” of private companies²⁶. However, the importance has now grown in research and specialized education in regard to the management and administration of NPOs, which do not fall within either of those traditional categories.

25) This is an inefficiency that occurs, not when a person undertakes certain work himself, but when the work is done by a hired agent (the case referred to as an “agency relationship”). This inefficiency, called “agency cost,” refers to the possible loss to the client arising from the possibility of an agent actions that prioritize the agent’s own benefit over the client’s benefit.

26) In professional graduate schools in the United States, there are two kind of Master’s degrees. The academic degree on completion for business school is an MBA (Master of Business Administration), and those specializing in public policy (for example, Princeton University’s Woodrow Wilson School of Public and International Affairs and Harvard University’s Kennedy School of Government), the degree awarded has been a clearly separate one, an MPA (Master of Public Administration).

(3) The Concept of Governance at the Core

The traditional understanding of policy has been that it is a decision-making and the implementation of those decisions as exercised by a legal and administrative authority of the central government. However, if we adopt a broader understanding as mentioned above, namely as social programs participated in and conducted mostly by the private sector including NPOs, then the new understanding will embrace the participation of diverse and multiple entities. In such a case, the flow of information as well as instruction is not unidirectional, but multidirectional and interdependent. If we understand decision-making and implementation of policy in this way, then we need to introduce the concept of “governance” to understand such a series of processes of actions.

The term governance has perhaps become one of the most popular and commonly used words of the last ten or so years (in both English and Japanese)²⁷. Governance has originally meant the control and administration of a specified region, city or state. But in recent years, it has covered a variety of other matters and come to be used with a variety of implications. For example, when the object is an organizational body (corporate body, etc.) as a comparatively small unit, the term has an overall meaning of a controlling structure that includes the process and manner in which the mutual influence of interested parties inside and outside the organization is controlled, organizational behavior is gauged, the mode in which discipline is applied and other elements (in the case of companies, corporate governance). Moreover, this concept is being broadly applied to various domestic and global issues (for example, environmental issues and their policy formation).²⁸ In this paper, I would like to set the definition of governance as: “a situation where some kind of authority or consensus is used to create a structure for an order or operative system among the interested parties.” If understood in this way, it may be said that the study of policy management is research related to different types of governance²⁹.

27) Incidentally, a search using Google’s search engine for websites included under the term “governance” on the internet detected approximately 68 million hits. In recent years, corporate governance has become a major point at issue, and if “corporate governance” is excluded from “governance,” the total number reaches 38 million hits. Similarly, when a search was attempted for books including the word “governance” using an online database search system (FirstSearch, which uses WorldCat as a database), there were approximately 20,000 items.

28) In the discussion of governance, usually such characteristics are included as follows (Iwasaki 2003). (1) Unlike government theory (which regards the governing apparatus as the issue), the actors subject to consideration are diverse; (2) participating entities make their own decisions without being coerced; and (3) actors belonging to the private domain (NGO/NPO, companies) also participate in public issues, thus making the mutual contacts and relationship between public and private entities closer.

29) Incidentally, the name of the graduate school at Keio University Shonan Fujisawa Campus (SFC) does not employ the expression “public policy,” but was given the name Seisaku- media kenkyuka (translated as “policy and media graduate course”) and particularly in English, the term governance is explicitly used as “Graduate School of Media and Governance.” The reason is that this title intends to show a broader understanding explained in this paper regarding “policy.”

If we understand the process of implementing social programs in this way, the key question is whether or not the implementation yields the ultimate goal. In other words, the value of a social program is to be judged depending on which nature it is associated with, either “a wonderful idea, but one that has a high possibility of ending up as an unworkable idea” or “highly feasible even though it is a second best scheme.” Put another way, social program indispensably includes, in order to improve the viability of the program, the study of how the concerned parties should respond to various situations. Consequently, the study of social program must include such issues as what sort of strategy should be employed in realizing the social program (strategic characteristics of policy), and what kind of tactics should be adopted once a strategy is given³⁰. That is, both strategy and tactics must be researched and presented as an integral part of the social program. In this sense, the study of policy management is not merely a science, but something that has characteristics of an art or a craft.

3. Transformation of the Methods of Public Policy Administration

The content of public policy, which was at the core of traditional policy analysis, has changed as mentioned above accompanying changes in the way social problem are perceived and solved. In other words, policy has shifted from emphasizing the content itself to institution-building. In fact, that is not all. The ideology of public policy administration and its methodology have also changed considerably in recent years.³¹ Here, we will trace and summarize the distinguishing features in the latest researches concerning public policy administration.

3-1 Industrial Design and Policy Design

The design of public policy has a considerably different nature from architectural design or industrial design. It is important to first understand this. The features of architectural design are as follows. (1) A static environment (it is only necessary to design assuming a given environment and materials). (2) Comparatively simple goals (it

30) Strategy originally refers to broad methods or stratagems for winning a fight (a higher ranking concept than tactics), and particularly, a plan or method for achieving a goal over a long period of time. By contrast, a tactic is a specific tool or method taken to achieve a certain goal (a lower ranking concept than strategy).

31) With regard to public policy, there are numerous issues besides how it is to be operated. They include, for example, the policy proposing entity, role of government officials, role of political parties, role of various advisory bodies such as advisory councils, and revenue source issues, but this paper is not concerned with these problems.

is only necessary to focus on the aesthetic appearance or economic efficiency). (3) Easily decomposable object (it is only necessary to put it together after the entire structure has been separated into several parts, or modules³², during the course of preparation). And (4) the aim of the design is to construct a material thing where no confrontations over values occur, so the result can be reliably predicted.

In comparison to this, the characteristics of policy design are as follows. (1) The environment being not only continually fluid and dynamic (policy subjects themselves are continuously moving over time) but the target itself is usually a human being whose priority is, for the most part, its own benefit. (2) Policy goals are often complex with conflicts often arising among them (trade-off relationship). (3) Because the problems are deeply associated with other factors, often the problem cannot be broken down into independently operable parts. (4) The object of the design (a group of people) differs internally in their values and interests, so results are highly uncertain.

If understood in this manner, it can be said that two factors make the design of public policy comparatively more difficult. One factor is the diversity, complexity (or ambiguity) and fluidity of the values of the policy subject (people). In other words, there is the problem of values or value assessments in public policy evaluation. This point has long been debated, and the existence of a consensus concerning values can be said to be an essential prerequisite to defining the form of the designed policy. Yet, even in cases where the values of the policy subject entity seem to diverge considerably, there exists a possibility for consensus formation to advance, to a certain extent, through a process designed into the policy (mutual communication among the relevant parties), so, in that respect, there are aspects that reduce the possibility of uncertainty in the policy assessment³³.

On the other hand, there is another challenge in public policy. That is that the policy aim is not a material object (thing), but a human being (person). When the government adopts a policy action (law, regulation, administrative guidance, etc.), there is no guarantee that the policy will influence a person surely and physically. It is different from a machine controlling an object, except maybe for the case where policy is accompanied by the provision of a subsidy or levying of a tax. In other words, a realistic judgment about the appropriateness of the design or the effect of a policy remains impossible, unless we take it into consideration that a man tends behave egocentrically based on the given information. If the aforementioned concept is employed, it is then necessary to consider public policy in a

32) The concept of modules will be explained in detail in Chapter 2 of this volume (Working Paper 126) utilizing the argument in Okabe (2005, Section 4).

33) This point is explained by Okabe (2005, Section 2-3) in Chapter 2 of this volume (Working Paper 126).

world where the Harvey Road presumption³⁴ (the mechanistic concept of public policy) does not hold. In order to design effective policy, it becomes essential to take into account two things: the informational asymmetry among the parties and the parties' incentives³⁵.

3-2 Asymmetry of Information and Important Points in Public Policy

Here, two representative cases will be cited which indicate that consideration of informational asymmetry is essential for the design of policy or institutions.

One is the issue of incurring moral hazard. Moral hazard originally refers to the loosening of the behavioral discipline when a person enters into some insurance contract. A classic example is the case when a person takes out automobile insurance, and the insured person's driving become wanton because he thinks that even if his driving is the cause of an accident, damages will be covered by insurance. Another example is that if someone obtains unemployment insurance, the person's enthusiasm for looking for a job declines when he becomes unemployed. There is also the case of having a deposit insurance system, or the "convoy-fleet approach"³⁶, which the Ministry of Finance (prior to the 2001 reorganization of government offices) used to exercise in regard to banks and which gave depositors a sense of security, so that they deposited their money even in badly-managed financial institutions (depositors' moral hazard). On the other hand, the same policy leads bank management to take higher risk in lending, because they expect that the government would come to their rescue in the end (financial institutions' moral hazard). The point is that, in all the cases, the insuring entity (insurance company, government, etc.) is not able to grasp the private information held by the insured, and it is from this uneven distribution of information or informational asymmetry that moral hazard originates.

More generally speaking, moral hazard comes from a situation where an individual has an incentive to act if the individual himself does not need to bear the social cost generated by his behavior. Accordingly, the phenomenon of moral hazard, generated by individuals pursuing one's own benefit, may be expressed as the undesirable act for society as a whole.

34) With regard to this meaning, see the discussion in Footnote 13.

35) This kind of understanding is derived on the basis of the information economics. In traditional market economic theory, it is understood that interaction among economic entities is done through only the pricing system, but information economics (or contract theory) is set up on the analysis of important points in strategic interaction among entities having private information. The explanation in the following section is based on this perspective. For commentary on this field, see, for instance, Yanagawa (2000), Ito & Osano (2003), and Salanie (2005).

36) This refers to an administrative method of keeping the entire financial system safe by using as its standard the least strict rule to allow the financial institution with the most inferior management to continue operating. In this policy regime, an operational failure of financial institutions is not publicly released. A somewhat more detailed explanation is given in 3-3.

Another unsatisfactory case is the taking place of adverse selection. This is, again, originally a phenomenon pertaining to insurance. For example, in the case of health insurance, a person covered by insurance may be considered to be a person who privately holds information that he has a higher risk of contracting a disease than the average person eligible for insurance. Consequently, the purchaser of insurance tends to a group of people where there is a high probability that the insurance company will have to actually pay insurance money. Despite the fact that insurance companies want to select people who have a low risk of contacting a disease, the reverse occurs. The result is not only that the insurance company's loss ratio deteriorates, but also that the problem is further intensified, because comparatively healthy people do not get insurance when an insurance company raises insurance premiums to cover such losses. In the case of adverse selection, the same as with moral hazard, a phenomenon occurs where the act of pursuing one's own benefit is no longer desirable for the insurance company (or society as a whole).

Criticizing this sort of individual behavior as reproachable does not solve the problem. Instead, it is more realistic and practical to design public policy on the assumption that entities holding private information will strategically use their superior information position for their own benefit. For example, in the aforementioned example, this situation may be reflected in a revision of insurance premiums or indemnity clauses in an automobile or unemployment insurance contract. Also, in the case of deposit insurance, it becomes possible for a public authority to guide these entities in the anticipated direction³⁷, by addressing the matter in ways such as balancing insurance premiums against the management risk of the financial institution (variable depository insurance rates) or adding schemes to the approach of regulating financial institutions (introducing prompt corrective measures for management which are based on the level of the bank's capital adequacy ratio). It is imperative for insurance companies and public policy authorities first to recognize that institutional structure modifies the behavior of insured persons, depositors, and financial institutions. And then it becomes necessary to design desirable contracts and regulatory systems so that institutional structure induces to reveal incentive optimally for a society under the condition of informational asymmetry. The keyword is incentive for the economic entity. We will look at this in somewhat more detail next by taking the case of public policy for stabilization of the financial system, an instance where this is most clearly demonstrated.

37) Variable deposit insurance premiums have not yet been introduced in Japan, but were introduced in the United States in 1993. With regard to this point and prompt corrective measures, see Okabe (1999, Chapters 12 and 13).

3-3 From “Command and Control” to Emphasizing Incentive-Compatibility

Apart from cases accompanied by government budget disbursements such as subsidies, the administration of public policy is broadly divided into two approaches.³⁸ One is the command and control approach. In this approach, the state authority communicates to the private entity, which is the policy subject (for example, ordinary companies and financial institutions), what it may do and what it may not do, in an attempt to achieve the policy goal by monitoring if the private entity is in compliance or not. Here, let’s take a look using the policy for supervising financial institutions as an example.

The example, which has often been discussed, is the “convoy-fleet approach” that the former Ministry of Finance (prior to the 2001 reorganization of government offices) undertook vis-à-vis the banking sector. According to this method of implementing public policy, the rationale was as follows. (1) Achieving the management stability of all financial institutions by applying, on the one hand, with the easiest criteria which even the most inferior financial institution could meet, and by strictly regulating, on the other hand, the introduction of new financial products and the establishment of new branches. (2) The Ministry of Finance providing some bailout measures to financial institutions which were experiencing difficulty in remaining in business without assistance. And (3) giving depositors a sense of security, because failures of financial institutions would not become public under this circumstance. Decidedly, these policies prevented any outbreak of financial crisis for many years, and may be said successful in stabilizing Japan’s financial and payment systems. But it must be noted that accomplishing policy targets in this manner owes to several conditions being satisfied. Namely (1) position of the regulatory authority having information superior to private financial institutions; (2) lack of noticeable evasive action of regulation, and (3) generating relatively small inequality among financial institutions.

Subsequently, however, the technological innovation in finance and financial globalization undermined these conditions. The situation has now become one where private financial institutions surpass the regulatory authority in terms of both quality and quantity of information on financial practices, products, risk management technology and so on (informationally inferior position of the regulatory authority). Also, due to the growth of derivatives, cross penetration of the various markets has advanced with the result being that the regulation of separate financial business categories as well as short- and long-term financial regulation has substantially lost their significance (loss of regulatory effectiveness).

38) The account below is based upon Okabe (1999: Chapter 12, 2003a).

Moreover, the indiscriminate regulation vis-a-vis innovative financial institutions which had actively developed new financial products and methods, and less innovative ones which had not done so, increased inequity among financial institutions (increased inequity due to regulation). The result was that the convoy-fleet approach lost its effectiveness in attaining policy targets and wound up being abolished.

How should the authority respond to these kinds of new conditions? Under such circumstances, information held by the private sector should not be siphoned off by the government, but it is not only informationally more efficient to allow information to be utilized directly by the private sector but also efficient from the viewpoint of incentives for the private sector. In a case where various regulations are repealed and competition is promoted, that ends up ensuring fairness. The approach to policy administration, which has developed in recent years out of this point of view, is generally known as the “incentive-compatible approach.” This approach to policy administration sets the primary object as the reconciliation of the behavioral motives (incentives) of the private sector (financial institutions), which are in the position of being regulated, with social targets. This approach has already been introduced in many aspects of bank monitoring policies. For example, it provides greater managerial autonomy to banks having superior management conditions (reducing the frequency of the supervisory authority’s inspections). Also, institutions based upon this concept have already been introduced in Japan as well. Examples include the following: the “internal model” approach³⁹ regarding market risk management of financial institutions; the introduction of prompt corrective action structured so the response of the policy authority is invoked automatically using the capital adequacy ratio when a financial institution lapses into economic deprivation. Besides these, there are two examples. One is variable deposit insurance premiums corresponding to a bank’s management risk, a scheme implemented in the United States, but not realized in Japan⁴⁰. The other is a concept for an advance self-assessment system regarding maintenance of the capital adequacy ratio, a scheme being studied in the United States.

Also, there has been an increase in recent years in making practical use of “public comment procedures” in public policy (particularly when government regulations are introduced). From the standpoint of information possession, this scheme can be said to be a measure that is now necessary in order to conquer the expanded informational asymmetry between the government and the private sector (informational inferior position of the

39) This is a method of monitoring banks with regard to market risk to which financial institutions are exposed. In this scheme, the monitoring authority accepts as a valid official risk measure, under a given set of conditions, the risk assessed by private financial institutions using its internal assessment models.

40) See Footnote 35.

government). Also, we may say that involving a regulated entity (private companies) in the process of preparing regulations increases the regulatory effectiveness. This is because the regulations are ones that the regulated entities themselves have participated in preparing, so that, from the viewpoint of incentive compatibility, the regulations become easier to comply with.

Recent public policy, as these examples show, has made a considerable shift conceptually away from the traditional “approach based on command and control” to an “approach having incentive compatibility.” This course is expected to advance even further when one considers changes in the environment, such as the IT revolution, globalization of transactions, and further penetration of market mechanisms.

4. Comparing Traditional Policy Studies and Policy Management Study

When understanding policy study in the sense of solving problems in human society, traditional policy study (public policy study) and policy study corresponding to the changing environment (policy management study which is discussed in more detail in the next chapter) may be understood through a comparison such as that given in Table 3.

First, when considering the main policy entity, there is a fundamental recognition in conventional policy studies that the government is the main entity and the private sector is subject to the policy. Consequently, policy is redeemed as public policy and implemented by the government. In comparison to this, the study of policy management is based on an understanding that the interaction between the government and private sector is important in identifying issues that need be addressed, proposing measures and then implementing them. Therefore, when resolving problems, it is not merely the government, but also NPO/NGOs and other similar actors that are regarded as playing an indispensable role. And it is understood that a response to the issue by comprising all of these principal entities is the implementation of a “social program.”

Consequently, the methods of administering policy are contrastive. That is to say, in traditional policy studies, it is understood that the government executes commands and controls based on laws and administrative authority. In comparison, in the study of policy management, policy administration is understood as considering all behavior that reflects the reputations of NPO/NGOs and incentives of the private sector in addition to government action. And an order or equilibrium is presumed to emerge through these interdependent relationships (governance), within which social programs are advanced. In

contrast to traditional policy where policy actions are unidirectional and understood to have a once-only, static effect, the result in policy management study is that actions to resolve a problem are interactive and thus understood to be repetitive and dynamic.

Traditional policy studies have assumed several prerequisites for ensuring policy effectiveness. Namely, an implicit assumption (Harvey Road presumption) have been made, which held that the centralization of information within the government is comparatively easy, that the government has informational superiority and that the government is (or can be) wise and respond fairly. However, because these conditions have been considerably broken down by the IT revolution so that information sharing and searching have been eased dramatically within the private sector. Thus the traditional informational superiority of the government has been lost and the situation has been reversed, expanding informational asymmetry between the government and private sectors. Additionally, government policy is in the first place not something implemented based on complete information by fair and impartial wise people, but is, in fact, the product of a political process. It has become also necessary to aptly recognize the reality that in recent years market pressure has grown over administrative pressure. Policy management study, which takes into account precisely these changes, are surely endowed with the necessary qualifications to be effective as a method for resolving problems in a contemporary society.

Then, what kind of structure does policy management study have? And what sort of methods does its approach use? These are precisely the questions we ask in the next chapter.

**Table 3 Two Understandings of “Policy”:
Conventional Policy Studies and Policy Management Study**

| | Conventional policy studies | Policy management study |
|--|--|--|
| Nature of policy | <ul style="list-style-type: none"> • Public policy | <ul style="list-style-type: none"> • Social programs |
| Main policy entity | <ul style="list-style-type: none"> • Government is the main entity. Private sector is the object to be worked on. | <ul style="list-style-type: none"> • Interaction between the government and private sector has become important for identifying the issue to be addressed, devising measures and implementing them. • Increase in entities (NPO/NGO) capable of solving the problem |
| Administrative methods | <ul style="list-style-type: none"> • Law and administrative authority • Perspective of command and control | <ul style="list-style-type: none"> • Premised on behavior supported by the reputation of the NPO/NGO, and incentive compatible behavior of the private sector. • Perspective of governance (emergence of order from within an interdependent relationship) |
| Administrative behavior and its effect | <ul style="list-style-type: none"> • Unidirectional • Static | <ul style="list-style-type: none"> • Interactive • Repetitive and dynamic |
| Assumptions of effectiveness | <ul style="list-style-type: none"> • Compiling information to the government is comparatively easy and the government has informational superiority • Government is wise and fair. (Harvey Road presumption) | <ul style="list-style-type: none"> • Revolution in IT technology has made private sector easier to share, retrieve and search information, thus reversing the government’s informational superiority. (Expansion of informational asymmetry between the public and private sectors) • Government policy is the product of a political process; and market pressure has grown relative to administrative pressure. (Importance of private sector incentives and more emphasis on market forces) |

Note: Table prepared by the author

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