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contraction do not, however, take us back to where we started, but to very different conclusions about what government should do, where, and how.

Government failure is pervasive (Wolf 1988), but not constant: while many of its causes are intrinsic to government, some vary with the institutional structure, political culture, and level of political and economic development. Even the illustrative list of seven of the causes of government failure presented below suffices to show that government failure is more extensive than most analyses assume: pervasive enough to make us want to move the analysis of the limits of government competence into the core of policy analysis rather than leave it on the periphery.

5.1 Cause One: Inadequate Penetrative Capacity

Government agents must learn about the society they want to influence. At the most basic level, they need to know who their citizens are, where they live, and some basic facts about them, such as income and occupation. For more ambitious endeavors, governments may need much more extensive information concerning patterns of social and economic interaction. To regulate companies' environmental impacts, governments need to understand firms' production processes and decision-making structures. To control crime, they need information about the character of criminal enterprises, the social structure of unstable communities, and the interactions between citizens and the formal and informal sources of order. To make old-age policy effective, they must understand how decisions to retire are made, how citizens will respond to incentives to save or policies that make them pay taxes for future benefits, and how the management of private pension systems by corporations, unions, and future retirees will respond to public intervention. In each case, effective intervention requires both extensive information about individuals and a sophisticated understanding of how different social institutions operate and how they will react to government action. "Penetrative capacity" can be defined as the degree to which government is capable of seeing into society and understanding its dynamics.

Penetrative capacity is one of the most important features that make governments "modern." Resistance to government information gathering is among the oldest forms of resistance to modernization (Scott 1985). Shortfalls in penetrative capacity are most likely to lead to government failures in less developed contexts. But while more developed countries are rich in certain penetrative capacities, such as well-developed statistical databases on population and incomes, they may be sorely lacking in less formalized ways of knowing. For example, taking police officers off the sidewalks and putting them in automobiles—undertaken under Progressive influence as a "modernizing" move—may cost them detailed knowledge of neighborhood personalities and dynamics (Kelling and Moore 1988).

Modernized governments, despite plentiful data, may lack nuance, especially as applied to marginalized subgroups: recent immigrants, for example, who often hesitate to share information with outsiders and whose patterns of response may be difficult for outsiders to model accurately. In short, governments in more and less

developed countries face different kinds of problems with penetrative capacity, but in both cases they are likely to commit errors arising from inadequate information about societies they seek to govern.

In order to penetrate and reshape societies, governments must have the legitimacy and efficiency to acquire information and mobilize consent, while simultaneously resisting capture by private interests. This trick is not easily pulled off: success in creating what Peter Evans has called “embedded autonomy” is probably the exception rather than the rule (Evans 1995). Where this does not exist, or cannot be generated, the agenda for the state must correspondingly shrink. The importance of penetrative capacity is one reason to take political and institutional context seriously in making policy recommendations. Thus developing countries with simultaneously embedded and autonomous states may successfully manage market-directing policies that would, where those qualities of governance are lacking, lead to results considerably worse than could be achieved by *laissez-faire* (Wade 1990).

5.2 Cause Two: Inadequate Voluntary Cooperation

As many conquerors have found, it can be very difficult to govern effectively a society that does not voluntarily cooperate with its government. Penetrative capacity depends upon citizens’ willingness to share information. In its absence, governments have to learn what they need to know by coercion, or by offering expensive incentives. At the least, governments need citizens to fill out census forms, companies to supply information on sales, and sublevel governments to share information about performance. At a more complex level, police forces need citizens to report crimes and provide leads, courts need to count on the veracity of testimony given under oath, and regulators need whistle-blowers to report their employers’ violations of securities and environmental laws. Without voluntary cooperation, the costs of penetration can be prohibitive.

Governments also need other forms of voluntary cooperation. Any system of income taxation depends upon citizens accurately to report their income, and to, in the main, pay the taxes they owe without the immediate threat of punishment. The criminal justice system needs to be able to count on most citizens’ obeying the law most of the time without calculating the risk of apprehension. Welfare systems need most recipients to be honest in reporting their earnings and family composition. If employers do not internalize the norms of non-discrimination, the difficulty of detecting violators will make equal-opportunity laws nearly unenforceable. In societies where trust in government and moral strictures against non-cooperation are low, government failure will be more pervasive and the scope of market and non-market failures that governments can efficiently correct will be narrow.

Few governments have enough legitimacy among their citizens to generate as much penetrative capacity and voluntary cooperation as officials want. Citizens and wielders of informal power often resist attempts to make society “legible” from the center (Scott 1998). Such resistance is not always bad for the citizenry: higher government penetrative capacity and voluntary cooperation can expand the range

of market failures that states can correct, but they can be used also for purely extractive purposes. Where government is fundamentally extractive rather than developmental, keeping its agents in the dark may actually increase overall social wealth by preventing the redistribution of resources from productive to unproductive activities. So whether improvements in government capacity in these areas lead to overall social improvement depends crucially on the honesty of those who operate the state machinery.

5.3 Cause Three: Institutional Overhead

Even where society is cooperative and social information plentiful, governments find other ways to fail. Instead of or alongside fixing private failures, officials can choose to serve themselves at the expense of public purposes by pursuing their own agendas without mobilizing consent (which we will call “subversion”), refusing to apply themselves (“shirking”), or using governmental power to enrich themselves or their cronies (“graft”). A well-designed government can reduce some of these problems but it cannot eliminate them all, and its attempts to limit them will likely cause other pathologies.

Typically, economists think of the relationship between higher and lower levels of organizations, such as governments, in terms of principal–agent relationships. Information asymmetry makes it hard for principals (the citizens with respect to elected leaders, or the elected leadership with respect to the bureaucracy, or higher-level officials with respect to lower-level officials) to ensure that their agents will comply with instructions: agents will tend to subvert, shirk, or indulge in graft. Principals thus need to develop mechanisms of enforcement or of incentive, which requires them to have the means to observe their agents’ behavior or measure its results.

But those mechanisms are certain to have costs of their own. Making and enforcing detailed rules imposes costs and saps agents’ energy and morale. “Red tape” is the other side of the coin of “corruption.” Civil service personnel policies, low-bidder procurement regulations, and excessive audit requirements all make the jobs of public managers harder, and often cost much more than they save (Anechiarico and Jacobs 1996). Incentive-based systems encourage deception and performance simulation, in accord with Dukenfield’s Law: “Anything worth winning is worth cheating for.”

The higher the cost of these mechanisms to check agent misbehavior, the greater the agency losses. The higher the agency losses in government, the smaller the range of failures of voluntary action it can efficiently correct. Societies in which shirking, subversion, and graft are morally acceptable, or at least not highly stigmatized, will find the cost of government very high, and the desirable scope of government activity correspondingly limited.

Inefficiency also arises at the level of decision making. Different systems of government have different numbers of “veto points:” positions from which action can be blocked. Each veto point creates an opportunity for some constituency to ask for some consideration for not using its veto. Where nothing is demanded but appropriate side payments to convert a potential Pareto improvement into an actual Pareto improvement by redistributing some of the gains from the change to those

who would otherwise be hurt by it—as in the familiar case of compensation for houses taken to build highways—this process is unproblematic; it can even help forestall projects whose costs in fact exceed their benefits. The problem arises when those who would not lose, and might even gain from the proposed policy use their veto-point position as a mere bargaining tool. At some point, the cost of paying off veto holders or their agents may make a project valuable in itself unfeasible, leaving the private failure it was to fix unremedied. Avinash Dixit refers to these payments as “political transaction costs” (Dixit 1998). Other things being equal, therefore, complex institutions, especially those with separation of powers or multilevel bargaining in government, should have larger political transaction costs.

On the other hand, systems with large numbers of veto points may also be characterized by more extensive deliberation. Every point where change may be stopped or compensation required is also a “deliberation point,” where additional facts may be considered, arguments heard, consequences predicted. Systems that attempt to lower the cost of compensating veto players through centralization may be likelier to make big, costly mistakes due to haste, a cramped set of options, and insufficient foresight (Butler, Adonis, and Travers 1994). Thus centralized systems with fewer veto players are likely to have significant costs of decision making as well, but these will be large and relatively infrequent, while in decentralized systems the costs will be relatively small but marbled throughout most decisions. Either way, the process of decision making raises the cost of government intervention to correct private choice failures.

5.4 Cause Four: Voter Attention and Inattention

Voting, and related electioneering activity can be thought of as both information-gathering processes and decision processes. But there is no compelling reason to expect that voters will act in the public interest, or even in the interest of the smaller groups with which they identify. The outcome of an election is a public good, and efforts to influence it therefore suffer from free-rider problems.

A purely rational citizen would not even voluntarily vote—let alone engage in more costly political activity—unless under the dictates of conscience or reputation, because his private gain from having his candidate win the election, multiplied by the (vanishingly small) probability of his vote proving decisive, is smaller than his private cost of voting. The public choice literature considers it a paradox that people vote at all (Fiorina 1990).

Even if someone decides to vote, the private return to studying the candidates and issues is so small that a rationally selfish voter would remain “rationally ignorant” and so be unable to cast an informed vote (Downs 1957). If voters are usually uninformed, then elected officials have no strong incentive to serve voters’ interests.

Olson (1971) theorized that groups that are comparatively successful in politically mobilizing their members—according to Olson by offering private rewards for participation—tend to overcome their less well-mobilized, even if larger competitors

(Olson 1971). That might not be true of voting, but it is a powerful insight into other forms of electoral activity, including financial contributions. “Private rewards” in Olson’s sense need not be pecuniary: someone who attends a political fundraising event in part to meet the other attendees, and to be seen by them, derives a private benefit from attendance, a benefit from which non-contributors are excluded. Those private benefits, which James Q. Wilson calls “solidary benefits,” can help overcome the free-riding problem (Wilson 1995). By the same token, the collective interests being pursued can be what Weber called “ideal interests” as well as material interests; the problem of whale lovers organizing to save the whales is analytically similar to the problem of veterans organizing to increase veterans’ pensions.

Actual election turnouts disconfirm theories that predict turnouts close to zero, so the equation of *homo politicus* with *homo economicus* seems not to be a correct model of gross voting behavior. But that does not prove that free riding, in the form of rational ignorance, is not a substantial problem in democratic systems. And concern about the nature of the private benefits offered for political contributions is at the center of the ongoing debates about campaign finance reform. Thus there is reason to doubt that any decision-making process with mass voting at its base will produce consistently optimal decisions, or create strong incentives for elected or appointed officials to serve the public interest.

But the consequences of this argument for specific policies are perhaps less sweeping than they might seem. The fact that imbalances of attention frequently lead to policy biased toward the attentive does not mean that policy changes are never made in the interests of large, diffuse groups and against concentrated interests. They often are, as a quite substantial political science literature demonstrates.¹³ These analyses demonstrate that what concentrated interests get from their attentiveness—and often their financial contributions—is reduced scrutiny from policy makers (Hall and Wayman 1990). However, when some focusing event or factor leads to heightened scrutiny, many of their advantages disappear.

That suggests that heightened public scrutiny improves decision making on a particular issue. Yet the public (under the spell of rational ignorance) will not attend to everything at once, or to any one thing (a few perennial issues excepted) for very long (Baumgartner and Jones 2005). So what happens after reform happens?

Other things being equal, the answer is that as attention shifts, the underlying, inherent imbalance of power reasserts itself, and the reform is slowly undermined. Eric Patashnik has demonstrated this pattern with such signal “public interest breakthroughs” as the 1986 Tax Reform Act and the 1996 Freedom to Farm Act (Patashnik 2003). Policy remains durable only where institutions or rules are put in place that make reversal difficult, or where exceptionally creative bureaucracies are established to act as policy guardians. Absent these factors, policy-making “regression to the mean” due to systematic inequality in attention should be factored into analysts’ recommendations.

¹³ Among the most important contributions are Arnold 1992, Landy and Levin 1995, and Baumgartner and Jones 1993.

5.5 Cause Five: The Path Dependence of Political Decision Making

The calculation that, given their relative defects, government decision making on some topic would produce better results than purely private choice does not exhaust the room for comparative analysis. The decision to prefer government decision making in the present may make reverting to voluntary decision making difficult in the future, if the original calculation proves incorrect or if the relative efficiency of markets and governments changes. If the recalibration of government response is more sluggish than the private response, and if the character or intensity of the problem varies over time, a policy choice that looks rational in the present may prove suboptimal over the long term. As a general matter, political decision making tends to be more path dependent than market-based decision making, because of the higher costs of mobilizing consent in political—especially democratic—systems.

The extent to which political decision making is path dependent (Pierson 2000, 2004) is largely determined by the design of institutions. Systems with large numbers of veto points usually make it relatively difficult to re-evaluate existing commitments, although they may make it easier to create new, and in some cases competing governmental responses.¹⁴ Systems with fewer veto points generally make it easier to re-evaluate existing commitments, but the limited carrying capacity of the political agenda makes it harder for alternatives to get sustained policy attention.

“Corporatist” systems where decision making occurs largely at the top levels of relatively few organizations may find it easier to engage in incremental adjustment of existing commitments but because of the size of the organized units, difficult to generate support for major reassessment that imposes large costs.¹⁵ Interest group systems, by contrast, may find it hard to adjust incrementally to problems, but because of the relatively small size of their organized units, easier to impose large costs when entrenched interests lose control of the agenda.¹⁶

Geographically centralized systems that encompass substantial diversity are likely to find it hard to mobilize consent to re-evaluate existing commitments. But where they do, they can impose that choice over a large scale. Geographically decentralized systems need to mobilize less consent to introduce alternative solutions in some locales, and in some cases competition in the market for policies (Wittman 1989) can lead to optimal solutions, but multiple policies in a single national jurisdiction can also lead to redundancy or destructive competition.¹⁷ Moreover, widespread reforms under decentralized systems require political battles across a number of venues,

¹⁴ On the character of decision making in systems with multiple entry points, see Baumgartner and Jones 1993.

¹⁵ This is one account of both the spectacular, and highly government directed Japanese economic success in the period up to the Asian currency crises of 1987 and the extreme difficulty Japan has had in reacting to the resulting banking crisis.

¹⁶ On the relative characteristics of corporatist and interest group systems, see Scheingate 2001.

¹⁷ An argument for the superior decision making of decentralized systems is made by Michael Greve (1999). For an argument about the limits of decentralization, see Teles and Landy 2001.

making it difficult to focus public attention sufficiently to overcome concentrated interests. Systems that delegate a great deal of decision-making authority to bureaucrats tend to have greater flexibility in adapting policies to changing circumstances than those that tightly circumscribe bureaucratic autonomy, but this advantage comes at the risk of bureaucrats' wresting effective agenda control from their political masters and the voters who choose them.

So while some institutional designs may improve the flexibility and reduce the path dependence of governmental responses to private choice failures, all carry risks of their own. While the institutional form matters, and in some cases matters a great deal, almost any form of political decision making involves quite substantial transaction costs in moving from one set of responses to another. But these macro-institutional factors are not the only considerations in explaining the relative stickiness of government solutions. Policies themselves create rules, institutions, and incentives that make them more or less easy to change, and may make reform more or less efficient and timely (Pierson 1994). These factors are, to some degree, under the control of the persons making the original decisions about whether to choose government or private control, though of course their evolution over time is only imperfectly predictable (Volokh 2003). Some decisions that increase adaptability may impose other costs, including difficulty in assembling the coalition necessary to enact the new policy in the first place.

5.6 Cause Six: Competition for Technical Expertise

While some public goals can be achieved through means that require only limited sophistication among public employees, others are intrinsically complex and require professionally informed judgement. In any society, at any moment, there is a fixed set of such skilled personnel, distributed between government and the private sector. The range of market failures that a government can effectively remedy will depend, in the first instance, on attracting individuals competent to carry out the task at hand. In other cases, government must attract workers who are not just competent but are competitive with their private sector counterparts. (Regulators must not be too far inferior in skill to those they regulate, or investigators to the crooks they try to catch.)

Attracting skilled individuals to public service becomes a more significant challenge as the scale of modernization increases. As societies become more complex, regulating them becomes harder, increasing the need for highly trained public servants. Yet increased social and economic complexity is also accompanied by increasing premiums for skill in the private sector (Frank and Cook 1995). Where egalitarian impulses, or concerns about the corruption that can result from placing large numbers of high-paying jobs in the gift of elected officials, make it difficult for the public sector to pay competitively, there will be a tendency for skilled personnel to leach out of the public sector, leaving government to select among the least competent or most risk-averse personnel. The result can be a downward spiral, where low salaries lead to poor performance by public agencies, poor performance

to public disdain, and public disdain to low salaries. Norms making politicians and “bureaucrats” the bearers of stigma and the butt of jokes make the problem worse and can act as one mechanism of the downward spiral.

Government could respond to this competition by deregulating its own determination of professional salaries: it could empower managers to hire fewer but more highly compensated individuals or to spend more money on salaries and less on other things. While such deregulation almost always creates some risk of encouraging destructive forms of public job seeking, those risks need to be judged against the less visible effects of low overall civil service quality (DiIulio 1994).

The degree to which government is able to organize itself to compete for these highly trained and compensated individuals will substantially determine its ability to correct private choice failures in these areas. Such reforms are almost always difficult for governments to achieve, and competing with the private sector will tend to become more problematic as the level of development increases, sending the top end of private compensation ever higher.

What this suggests is that governments may have to consider the possibility that certain forms of regulation that could potentially correct significant private choice failures are unlikely to be effective given the competition for skilled personnel. What is more, where the regulators are significantly less talented than those they regulate, the presence of any government intervention at all may be worse than a completely unregulated environment. Governments may be better off with a clear, unambiguous policy of *laissez-faire* than with clumsy attempts to regulate processes that their civil servants cannot understand.

5.7 Cause Seven: Weak Administrative Culture

The quality of administrative agencies is not only a function of competition with the private sector for skilled individuals, because agencies are not simply aggregates of individual agents. Agencies are structured in particular ways through a process of historical inheritance that produces a relatively stable administrative culture. Moreover, agencies are embedded in a larger political culture that establishes expectations about how those agencies should operate, their scope for entrepreneurship and leadership within a system of separated powers, the degree to which they focus on problem solving as opposed to distributive politics or patronage, and the degree to which public service is considered an honorable or even respectable occupation.

Both the quality of an agency’s administrative culture, and the orientation of the larger political culture that it is embedded in and draws upon, limit the interventions that a political system can contemplate. Lawrence Mead (2004) observes that Wisconsin was as successful as it has been with highly directive welfare reform in large part because it could draw upon a progressive political culture: one with a low tolerance for uncivil behavior, an orientation toward disinterested examination of

social problems, and a legacy of efficient and entrepreneurial administrative agencies, connected to high-quality educational institutions designed to produce analytically skilled administrators. This set of inherited attitudes and institutions allowed the state to set ambitious goals for welfare reform, to work through the administrative consequences of those goals, and to make them a reality at the level of the street-level bureaucrat.

Mead shows that a culture of administrative quality is a precondition to making complex policy changes work. Motivating welfare clients actively to seek work and organize other parts of their lives requires that welfare administrators themselves be trained, equipped, and motivated. It requires that outcomes be closely tracked, and those outcomes fed back into an ongoing process of policy and administrative reform. Finally, it requires that the overall political system recognize major policy reform as a long-term process, which depends upon being willing to use bad news to make incremental changes rather than using it to score political or partisan points.

These requirements exceed the administrative and cultural inheritance that most states are able to draw upon. As a consequence most states have settled for less, counting upon changes in the larger economy to do most of the job of driving down welfare rolls, or imposing benefit cut-offs without the benefit of close supervision. Some states have recognized that their administrative culture fell short of their ambitions to replicate Wisconsin-style welfare reform, and have attempted to build up such a culture on the fly. While they have had some success, they have also been pushing against their administrative inheritance, requiring them to engage in “state building” at the same time as they were putting in place a new policy, but without the supportive cultural background that Wisconsin could count on. Their results have been correspondingly modest.

This suggests that policy makers need to recognize that administrative quality, and the cultural background that it rests upon, cannot be assumed, and can be created ad hoc only to a limited degree. Where the inherited administrative culture is weak, policy aspiration must be scaled down correspondingly.

That being so, the impact of a proposed policy change on the administrative culture may be more important, in the long run, than its immediate costs and benefits. A good public manager is not merely a skilled administrator of current policies, but a good steward of his or her agency’s capacity to produce public benefit into the future.

6. PUTTING IT TOGETHER: POLICY MAKING IN A WORLD OF IMPERFECT ALTERNATIVES

Human beings and the social groups they form are astoundingly self-regulating, capable of remarkable feats of optimization without external direction, especially if

the market is allowed to exert its power of making every participant's wants a motive for others to satisfy those wants. That insight remains the key to the fundamentally liberal form of social and political organization that has enjoyed such spectacular success over the past three centuries.

But neither individual nor social self-regulation is perfect. Economists have assembled a growing catalog of market failures; when markets fail (fail, that is, to reach Pareto-optimal outcomes) there may be scope for the coercive powers of government to improve matters. There exists no comparable catalog of the failures of individual self-command, or of the failures of non-market forms of voluntary cooperation, but their existence is hard to deny. Once such failures are recognized, both paternalistic intervention to protect individuals from themselves and interventions designed to rectify the failures of the institutions of civil society appear as justifications for government action on a par with the classical market failures.

Still, no situation is so bad that it can't be made worse. To say that a condition is suboptimal is not to say that coercive intervention by the state will improve matters. State action is subject to its own list of suboptimalities, known in the public choice literature as "government failures." Moreover, coercive intervention can if not carefully designed, worsen the individual and institutional failures whose consequences it sets out to correct. A comprehensive policy analysis therefore requires an analysis of both sets of failures, with an eye not merely to the best resolution of the current controversy but to the "constitutional" consequences of a decision to act, or to let be.

If the foregoing argument is correct, it has important consequences for policy areas beyond the scope of our analysis, and in particular to the problem of distribution.

On the one hand, there are some powerful arguments for increased equality: the diminishing marginal utility of income, the measured impacts on individuals' physical and psychological health of having low relative (as opposed to absolute) income or wealth, the difficulty of maintaining equality of opportunity when children grow up with very different levels of family advantage, the incompatibility of democracy as a political ideal with the differences in political power created by extreme economic stratification, the destructive social tensions extreme stratification can create, and the prospect that reduced stratification might lead to reduced wealth-signaling behavior and thus welfare-enhancing shifts of energy from material acquisition to living well.

But the analytical leverage to be had by a wider recognition of areas where the results of private choice may be suboptimal needs to be accompanied by an assessment of the likely governmental response to the demand for a wider scope of redistribution. Enforcement of a collective decision to reduce working hours, for example, depends upon the supervisory and coercive powers of government, and also perhaps, on the ability of government to hire staff sophisticated enough to detect cheating. Such policies might also be subject to the attention disequilibrium described above—while the public may be highly aroused to create such a policy, those who most immediately feel its costs (such as employers) are likely to sustain their interests in undermining its impact in practice. Unless a means is discovered to

maintain the public ardor that created the pressure for the income–leisure swap in the first place, its impact may be severely degraded over time, while imposing administrative costs that could, in the aggregate, make the policy worse in practice than no policy at all.

This analysis touches the very core of political theory. The inheritors of Rawlsian political philosophy rarely consider the shape and character of the political institutions that will be created to bring into practice the distributive preferences deduced from behind the veil of ignorance. But those reasoning about justice in ways intended to connect to the real world need knowledge of the predictable effects of the operation of actual political institutions. (An important exception to the absence of sophisticated analyses connecting political theory and institutional design is Rothstein 1998.) The shape of desirable redistribution may be altered by a recognition not only of what actual political institutions will do with the demand for extensive redistribution, but also what institutions so empowered will be able to do to (and perhaps for) citizens when their scope has been increased. Ultimately, normative political economy must grapple with institutional and political questions.

Public policy, institutional analysis, and political philosophy do not deal with three distinct subject matters; rather, they are three different attempts to deal with the problem of how human beings ought to govern themselves. The world will not be well governed until the statesmen learn to pay attention to the results of careful thought and the thinkers take the problems of statesmanship seriously.

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