

## CHAPTER FOUR

### Policy Coordination: Government, Market, and the Civic Sector

Martin Potucek

#### Introduction

Political economist Adam Smith never distinguished between economic and political analysis of institutions, interests, values, interactions, or market itself. However, the holistic approach of traditional liberal thinking suffered numerous attacks in the course of the centuries, which followed the publication of Smith's works. The 19th and 20th centuries were witness to a veritable schism: economics concentrated on the analysis of economic relationships, while political science concentrated on analyzing political processes. This evolution reflected, to a certain extent, a new trend of differentiating between scientific disciplines. On the other hand, this rift steadily led to economists' and politicians' disregard of the realities which were routine for Smith: the conjunction and interdependence of politics and economics; much that is political is economic in nature and economies are, to a large degree, also political. At the same time, individual societies significantly differ in their concept of the regulatory function of the government and the market. Mainstream political science and economics, however, have left the basic question of the role of government and the market unresolved, instead limiting themselves by analyses confined to disciplinary analytical frameworks.<sup>1</sup>

Lindblom (1977) suggests deriving an analysis of the functioning of global societies from the definitions of the following elementary politico-economic mechanisms (regulators), which influence and support human lives and societies:

- government, the expression of political power
- the market, a medium of exchange
- education (indoctrination)<sup>2</sup>

---

<sup>1</sup> Institutional economics and public choice theory are important, but rare and not fully satisfactory exemptions.

<sup>2</sup> Typical agents of indoctrination are educational systems and mass media. Indoctrination can have a political motive (then it is often guided by a specific ideology) or economic motive (advertisement). Producers and reporters may find themselves in situations, when it is in their personal interest to give partial or biased/distorted information.

Streeck-Schmitter (1985) state that the social sciences traditionally uphold society, the market, and government as the key mechanisms of maintaining social order. They point out, however, that this list is incomplete, adding to it another item - the association.

Table 4-1: Models of maintaining social order

Regulative model	Regulative principle	Specialized scientific discipline
society	spontaneous solidarity	sociology
market	competition	economics
government	hierarchical control	law, political science
associations	harmonization through organization	organizational theory, sociology of social movements

Wolfenden's commission (The Future, 1978) suggested classifying regulators according to the following table:

Table 4-2: Types of sectors regulating people's actions

Private informal sector	Private commercial sector
Government	Civic sector (Non-profit organizations)

The advantage of the suggested classification is that it differentiates between the private informal sector (family, neighborhood, informal groups, community) and the civic sector (associations, non-profit organizations), which in other studies fall under the more general category of civil society (Archer, 1994). This difference is crucial, because it is their organizational structures, which significantly distinguish non-profit organizations from the private informal sector, at least at an elementary level of formalization.

Besides the regulators identified by Lindblom, Streeck-Schmitter and the Wolfenden commission, we should not omit another sphere which is central to ethics and social philosophy, the socio-cultural values of a given society (narrowly defined as morality, value orientations and cultural patterns of behavior pertaining to individuals, as well as entire societies).

From public policy's standpoint, however, primarily three of the previously discussed regulators stand out: the market, government, and civic sector. Therefore, the following chapter is dedicated to illustrating the role of the market, government, and the civic sector as rudimentary politico-economic mechanisms, functioning in democratic societies with market economies. This is done with the recognition that in forming and implementing public policy, the key is to

understand the advantages as well as the failures of the market, government, and civic sector, and thus to be able to identify the fields of their potential interference and conflict, as well as synergy and mutually supportive application. In short, the art of public policy making is to find an appropriate balance in their roles as regulators of public affairs.

A problem thus conceived, has contemporary relevance in comprehending processes, which have been taking place throughout Central and Eastern Europe since 1989. It concerns such politically sensitive issues as democratization of political systems, reform of public administration, the transition to a market economy (incl. privatization), the fertile conditions for the rise of corruption and mafia activities, and the birth and functioning of a civil society. The study *Not Only the Market* (Potůček 1999) uses this theoretical framework to explain these processes, taking the case of Czech Republic as *pars pro toto* (but with some references to other post-communist countries as well).

In the following analysis, we will address the advantages and failures of the market, government, and non-profit organizations. In conclusion, we will return to certain issues that relate to the concurrent use of these regulators.

### **Market advantages and failures**

*"The market resembles fire: it is a good servant, but a cruel master."*

The market is a self-regulating system in which supply and demand, profit and loss allocate scarce resources (goods) more effectively than any other known regulative mechanism. The market mechanism is based on a voluntary agreement, between seller and buyer, about the exchange of rare resources. Balanced price systems, which regulate both production and consumption, are created on the basis of millions of such exchanges.

Prices generated by the market are signals, used by people as guides to maximizing individual profit for the minimum expenditure of resources at their disposal. Regulation by means of the market, therefore, is derived from the assumption that individuals attempt to maximize their own gain, to the extent that the market makes it possible. The individual (institution) only pursues his own egocentric interests. According to Adam Smith's theory, the magic of the "Invisible Hand" of the market rests in the belief that collective satisfaction is reached primarily through the pursuit of purely selfish interests and that society profits from the egocentric behavior of individuals engaged in the market transactions.

From the standpoint of political science, the exchange of goods in the market is an independent form of regulation, behavioral control, and cooperation among people. From the standpoint of economics, it is irrefutable that supply and demand as well as profit and loss, allocate scarce resources (while respecting given restrictions) more effectively than any alternative regulative mechanism (Barry, 1987). The market is, therefore, the best engine, instigator, and agent of economic growth.

The functioning of the market is based on voluntary exchange agreements between buyer and seller. The ideal model of a market economy is a balanced model. In the uncomplicated world of the market, with a perfectly competitive environment, prices evolve which distribute the input of firms and goods sold by buyers so that no other such combination of inputs and outputs can be found, which would increase the profit of at least one of the participants of market exchange without decreasing someone else's profit. This maximizes the sum of the attainable wealth of a society. At the same time, the prices of inputs and outputs of production and consumption are such that the supply of all goods is equal to their demand. Economists refer to such a distribution as being Pareto efficient.

This distribution, however, is neutral in relation to the distribution of wealth among individual actors of exchange. In other words, it doesn't reflect the total wealth distribution between members of a given society. Therefore, were the market to be given free reign, the circular and cumulative processes brought about by repeated offer and demand would make those who already have a large amount of resources at their disposal even wealthier, and the poor would lose even the modest amount with which they entered the market (Myrdal, 1968).<sup>3</sup> Barry (ibid.) observes that among the effects caused by the long-term functioning of a free market unchecked by outside regulators, are unemployment and over consumption.

The market depends on the government and political power: laws guarantee personal freedoms (including the right to freely engage in market relationships) and protect private property. Rule of law backed by the state is, therefore, a precondition for effective market exchange. A functioning market also requires certain values and norms shared by all participants of exchange, including a considerable amount of trust. The combination of the above makes a type of social "capsule",

---

<sup>3</sup>This trait of the free market is sometimes called the centrifugal effect of the market: the wealthy push towards the center while the poor are repulsed to the periphery.

"(which) is (...) best understood as an interconnected set of normative, social, and governmental mechanisms, each with a distinct function, but which can also stand-in for each other, within certain bounds" (Etzioni 1988).

The advantages and failures of the market as a regulator of social interactions will now be analyzed in greater detail.

### *Market advantages*

"The market (...) is a general system of horizontal relationships between free and equal individuals. It is an arena where people freely choose, where they enter into voluntary contracts with each other and, thanks to this, realize their wishes, desires, needs, and preferences" (Klaus, 1996:304).

The market provides a tremendous amount of information about what people wish to gain and what is offered to them, and through prices, coordinates the supply of these goods and their demand in the activities of a great number of actors.

The advantages of the market, in comparison to government, include:

- the ability to maximize economic effectiveness
- a tendency to innovate
- rapid adjustment to changing conditions
- swift repetition of successful experiments
- the ability to abandon obsolete activities
- more effective performance of complex tasks
- creations of opportunities for the productive use of human inventiveness and entrepreneurialship.

### *Market failures*

If no other criteria than that of maximizing global economic effectiveness applied, and an ideal market environment existed, it would be sensible to aspire to reach Pareto efficiency, which would mean giving free reign to the market. Nevertheless:

- in politics, economic efficiency is not the only criteria applied;
- economic reality never entirely reflects the ideal of a purely competitive market.

### Failures of the market using criteria other than economic effectiveness.

Five separate criteria, which are derived from various normative models of society and are alive in current societies, will be considered:

- reducing inequalities in the distribution of wealth caused by the market forces
- maintaining institutional values
- maintaining human dignity
- cultivation and utilization of human potential
- maintaining sustainable development.

If these criteria are applied, then the market cannot entirely or even predominantly regulate the activities of social actors.

Those failures of the market as regulator, which stem from the existence of a market environment that doesn't reflect the ideal model of a market economy and therefore, appear even when criterion of economic efficiency is used, will now be discussed. The first to call attention to these failures was Arrow at the end of the 1960's.

Economic theory analyzes several typical situations where the hypothesis of an ideal market environment does not materialize:

- **The existence of public goods<sup>4</sup>**

Private goods are defined by absolute rivalry of consumption (that which is consumed by one, cannot be consumed by another) and by their exclusion from ownership and use: a specific individual has exclusive ownership of a given good.<sup>5</sup> Public goods are, in contrast, characteristically non-rivalous in consumption (non-excludable from consumption) and/or non-transferable to a specific owner or user. Therefore, they cannot be optimally allocated using the market allocation. An example of a public good is national defense.

- **The existence of externalities**

Externalities are defined as any negative or positive consequence (expenditure or profit), resulting from a market contract (concerning either production or consumption), which is transferred to someone who does not enter into the market relationship in question.

- **Natural monopoly of supply and demand**

A monopoly on the part of a supplier occurs when fixed production costs are high in comparison to variable costs, so that the average price decreases with the increase in the demanded production. Provided these conditions are met, it is possible for only one firm to produce the given good for a lower price than anyone else on the market. Also a market relationship distortion characterized by a single buyer (monopsonist) exists.

- **Informational asymmetry between seller and buyer**

---

<sup>4</sup>The border between public and private goods has not been determined once and for all, it can change with time. It is influenced by new technology, social situations, people's values, even political decisions (Mishan 1981).

<sup>5</sup>The right to exclude from ownership or use has two aspects: physical and legal. The legal aspect is referred to as ownership rights.

Informational asymmetry between seller and buyer occurs when the quality of the goods, which are the object of the transaction, become apparent only during or after they have been consumed.

We can distinguish between three types of goods:

- those whose quality is known before consumption (the majority of consumer goods)
- those whose quality becomes apparent only during consumption (most services)
- those whose quality becomes evident only after consumption (most medical services)

With the second and third types of goods, there is a danger that the seller will misuse his informational advantage to gain an undeserved profit; on the part of the buyer, the value of trust in the seller is increased (Arrow 1974).

The changing preferences of the market contractors. The ideal model of market economics assumes that the participating actors have constant preferences expressed by the relationship between their capacity to consume and the expected profit. It is evident that in many situations, preferences can be changed. (For example, influencing the demand for drugs.) Such efforts are mainly motivated by the desire to remove all possible negative externalities of one's actions.

Neglecting the future. The market reacts only to present interests, it is "myopic" and can provide the incentive to maximize short-term profits even if it means long-term losses. Manufacturers struggle to reach rapid return on invested capital; possible long-term consequences of a specific product and its consumption's effects on the fate of people are not taken into consideration.

Many other possible negative consequences of the market have been discussed besides the aforementioned failures in relevant literature. The market's lack of security and instability, negative effects of its adaptability, can cause negative social and economic effects locally as well as globally - for example, mass layoffs, bankruptcies, economic and ecological crises, etc.

### **Government Advantages and Failures**

Political power is, in contrast to the market and perhaps to indoctrination, a relatively simple means of regulation. Market regulation always requires sacrificing something in exchange for desired gain, and regulation through indoctrination requires time and systematic effort. Governmental control does not need to be costly, provided that the government can draw support from an established political power base. Understandably, establishing and maintaining

power is in and of itself costly. Specific control through power must be brought about either by direct force or through an enactment of law, which must be obeyed.

The efficacy of power explains its central position in government. There are rules, delegating this power to diverse units of government. Power even enters into transactions in order to define their conditions and sometimes enters into the exchange itself. The risk associated with the government's use of political power as a regulatory device, manifests itself in the potential abuse of this power, which can exceed the original authority invested in it. The failures of the government as a regulator of human and institutional activity will now be analyzed in more detail.

### *Advantages of the government*

Compared to the market, state authorities are more effective in:

- policy management
- administrative regulation
- rapidly mobilizing and using resources
- ensuring the continuity and stability of services
- preventing exploitation and discrimination
- ensuring public safety
- ensuring equity
- maintaining social cohesion

Decentralization of authority and responsibility can have many advantages, which are the mirror images of the disadvantages, or failures, of highly centralized systems of government. A general advantage of decentralization is that it transfers decision making closer to the citizen. In contrast to centralized systems, a decentralized state administration is more capable of adapting to the concrete conditions and wishes of its citizens; it allows more room for experimentation and finding alternative methods of problem solving.

### *Government Failure*

Theories of government failures analyze deficiencies in electoral systems and in the aggregation of individual preferences; they describe the risk of publicly elected officials becoming estranged from the voters; they attribute problems to bureaucratic apparatuses, to the role of mass media and unregulated political lobbying in influencing political decisions; they warn of the risks posed by the predominance of organized and articulated interests of a minority over the dispersed and rarely asserted interests of the majority (and vice-versa); and they analyze

the limitations of implementing collective decisions in decentralized systems of government.<sup>6</sup> However, as far as we are aware, no one has thus far tried to systematize and synthesize these findings into a complete theoretical system similar to the one, which addresses the market failures.

If we consider the relatively broad meaning of the term government, including all of the processes that bring about the generation and use of political power (Weimer - Vining 1992), we can separate government failures into five problem areas which are related to the functioning of totalitarian political systems, direct democracies, representative democracies, decentralized systems, and the act of governing itself.

#### *Failures of totalitarian political systems*

Insufficient internal regulation. *The weakening or direct absence of feedbacks in totalitarian systems causes these systems to be unable to adequately identify changes in external conditions and budding internal problems. For this reason they react to them inadequately or belatedly, if at all. This is related to the absence of feedbacks in the political system as well as in the centrally planned economy (Kameníček - Kouba 1992).*

Suppressing creative potential. In totalitarian systems, people are not able to sufficiently exercise their dispositions and skills, which undermines the overall functioning and effectiveness of these systems, and results in a frustrated population.

#### *Failures of Direct Democracy*

The problem with referenda. The very form of the question can influence the outcome of the vote (for example, if the question is posed in the negative, as a refusal, or in the positive, as an acceptance of the issue). It is difficult to formulate a question, which is clear, yet includes all of the important issues pertaining to the decision. The implementation of a decision arrived at through a referendum can significantly differ from the true wishes of the majority of voters.

Unspecified majority defeats a clearly defined minority. When a small group takes a principled and specific stance on a certain issue, yet the majority of citizens take the opposite stance, although it may be half-hearted and not representative of their specific interests, the choice of the majority prevails.

---

<sup>6</sup>As early as 1930, Chester Barnard published a work in which he analyzed possible failures of organizations. Since then, many theoretical models and empirical analyses of government failures have emerged from the workshops of

### *Failures of Representative Democracy*

The paradox of voting. The paradox of voting was described by Condorcet, later by Caroll, and formalized by Arrow (1966). Those who set the conditions, under which elections are to be held, have an opportunity to influence the results of the election and the success of individual candidates. Those who would not have had the chance to make their opinions heard are able to continually suggest new agendas to be decided upon. This causes an election cycle, which leads to the defeat of political coalitions, which find themselves in a state of imbalance.

Preference intensity and bundling. Several political issues exist which influence the decisions of voters. During an election, a candidate without a consistent and comprehensive program can win even if he did not gain the majority on a single issue, as long as he succeeded in satisfying individual groups of voters in those issues, which concern them, the most.

The estrangement of elected representatives from their electorate. The principal-agent theory describes the relationship between the principal, or supreme holder of power (in this case the voter), and the agent, or the actor who is delegated the authority to wield this power (in this case the elected representative). The theory points out that elected representatives may display opportunistic behavior, or behavior that doesn't necessarily reflect (and can sometimes be in direct opposition to) the wishes of the electorate. The electorate cannot easily control the behavior of the representative. This needs time and money and can never be completely effective.

The influence of organized interests (lobbying). Policies, which provide a small benefit to the general public, do not attract active political support because the cost of political activism, leading to the implementation of such policies, is greater than the expected benefit. On the other hand the interests of a small, organized group have a chance of being adopted through active lobbying. Even though the policy would only benefit the given group, its costs would be dispersed throughout the entire society. Lindblom (1977) points out that this phenomenon unsuitably benefits organized economic interests in democratic political systems.

Restricted time frame. The decision-making time frame of politicians is mainly restricted to one, usually the current term of office. This means that not just the market, but also the government, can be myopic. In other words, during the decision-making process, the promise of

short-term profit can outweigh long-term loss. This truism of democracy can be paraphrased by saying, that *children and unborn citizens do not have the right to vote*.

The influence of mass media. The role of mass media in influencing public opinion is generally recognized and systematically analyzed. The format and content of repeated information have an influence on the public's perception of public affairs. This does not have to involve purposeful manipulation; the choice of genres, agendas, and events, as well as targeting certain types of viewers, listeners or readers is sufficient. In addition, a mass indoctrination of the public via poorly regulated mass media (especially TV) is possible in democracy. This is one of the reasons for stating that the political system, for the most part, does not allow public policy to lean against responsible consideration of social costs and benefits. (Weimer - Vining 1992)

#### *Typical government failures*

Inefficiency and poor adaptability of bureaucratic apparatuses. This government failure is explained by several mutually supporting conditions:

- difficulty in evaluating benefits, especially those of governmental activities. Exact criteria with which to assess which departments function well and which function poorly, is rarely available
- insufficient competition that would apply pressure according to the changing needs of clients, rigidity in the structure of services rendered
- binding budgetary regulations that hinder the flexibility of responses to the changing conditions of government activities.

The estrangement of state bureaucracy from its purpose. This government failure is caused by the difficulty in ensuring the accountability of public administration, particularly in the following relationships:

- politicians and their subordinate apparatus
- superiors and their subordinates in a bureaucracy
- citizens and the civil servants.

In all of these relationships the estrangement of the apparatus from its purpose is apparent, made possible by informational asymmetry, i.e. the first subject in the relationship possesses much less information as the second subject. Due to this condition, room is created for the misuse of informational superiority by asserting private (whether it be individual or group) interests to the detriment of the public interest.<sup>7</sup>

---

<sup>7</sup>The supporters of public choice theory go so far as to assume that maximizing personal benefits, on the part of politicians and state officials, is their sole motive.

### *Failures of decentralized systems*

The difficulty of governing in decentralized systems. When it is necessary to accept and implement decisions regarding the competence of a greater number of decentralized units, decentralized systems of governance come up against a barrier created by an increased complexity of governing. Decision-making is delayed and the costs of implementing policies increase due to the need of negotiation and coordination among participating units. A reciprocal proportion is valid: the more room there is for autonomous decision making at the lower level, the less room exists for rapid and direct implementation of the decisions at a higher level.

The threat to public interests by enforcing group interests. Decentralization facilitates the enforcement of heterogeneous local and group interests, which attempt to “harness”, decentralized units of the state apparatus and use them for private benefit. This weakens the central government's ability to implement comprehensive policies, and undermines its primary function as the guarantor of the public interest.

Fiscal externalities. Where the authority to determine the composition and extent of public budgets and taxes is significantly decentralized, decision makers at a lower level may tend to neglect the resolution of problems, which may have a negative impact on the public budgets at a higher level.

The above descriptions of government failures are derived from the analysis of concrete processes. Relevant theories, however, haven't been sufficiently expanded to offer a definitive diagnosis of when, where, and why these failures actually occur.

### *A challenge to governmental practice*

Even the government is tackling the prevailing problem of rational choice: with limited intellectual and decision-making capacity, it is confronted by complex problems of modern civilization. Its stereotypical reaction in confronting this difficulty is to divide its problems into smaller segments, apply specialized skills to each of these separate sections, and make routine decisions by applying standard solutions developed for various categories of problems. Immediately, however, government is faced with new problems created by this approach: shortcomings in coordination, break-down in information flows, information overload of decision makers, institutional failures caused by the opportunistic behavior of administrators, and rapidly changing circumstances surrounding the chosen method of resolution. Within the governmental framework, conflicts in motives arise: political power is accepted because it brings security,

expected rewards, and future benefits to administrators, nonetheless, action is expected, which may often be unpleasant. The reaction to potential punishment may be pathological in the sense that individuals and institutions are taught ways in which to avoid punishment, rather than how to accomplish what is necessary (Skinner).

Many of the aforementioned government failures, however, are not fatal - we are not sentenced once and for all to coexist with such imperfect bureaucratic institutions. If Drucker (1994) is correct that life in organizations and with organizations is the destiny of contemporary people, we should not adopt a fatalistic attitude. We are definitely not witnessing 'the death of government'. On the contrary, we need a confident, strong, and very active government. Nevertheless, we must decide between a large but impotent government and a government, which is strong because it concentrates on decision-making and influencing, leaving the administration to others. We need a government which knows how to govern, and governs. It isn't a government, which 'administers'; it's a government, which truly governs.

As is stated in the conclusion of the UN Conference on Public Administration and Development, which took place in April 1996 in New York, "the resolution of the pressing problems of our time does not reside in the restriction of the government, but in the creation of better functioning government" (Public Administration 1996).

### **The Advantages and Failures of the Civic Sector**

#### *Defining the civic sector*<sup>8</sup>

The civic sector is spawned by civil society, which draws on the public's civic responsibility for its existence. Etzioni characterizes **citizenship** as a moral responsibility of the

---

<sup>8</sup> Besides the term *civic sector*, there are other expressions used more or less as synonyms, for example, *non-commercial sector*, *non-governmental sector*, *civic associations and initiatives*. Authors wanting to highlight the civic sector's position within the confines of the market and government, choose the term *third sector* (Streeten, 1993:1288). The term ***civic sector*** will continue to be used in our text (Brown, 1994), meaning ***the entire set of institutions enabling citizens led by motives other than profit to associate, including the conditions and resources which are created for them. The individual institutions in this sector are called non-governmental organizations (NGOs) or non-profit organizations (NPOs).***

individual to the society in which he lives.<sup>9</sup> This responsibility prompts individuals to do something for others.

"...if the (concept of citizenship) is introduced in the home, cultivated in schools, promoted in the media, propagated by volunteer associations, and heard in the speeches of presidents and other civic leaders, a nation feels bound to contribute to the prosperity of its society" (Etzioni, 1988).

**Civil society** may then be understood as

"...an independent, self-organized society whose individual parts voluntarily involve themselves in public affairs in order to satisfy individual, group, or public interests in the framework of a legally defined relationship between the state and society" (Weigle-Butterfield, 1993).

Civil society operates through constantly creating, fulfilling, and dissolving social relations between citizens. It enables citizens to collectively express and act upon their opinions and values. Civil society encompasses two basic components:

- a legal framework defining the conditions of the relationship between government and self-governing institutions
- social actors characterized by their civic attitudes towards public concerns, as previously defined by citizenship.

It is necessary to understand that situations may arise when a society has the potential for citizenship, but the government does not create the necessary institutional framework for its cultivation and utilization. Citizens are, therefore, left with no choice but to find alternative (even illegal) means of association in order to realize this potential.

The **civic sector** is the institutional manifestation of the existence of civil society. It is formed by non-profit organizations, which are a form of volunteer association of citizens who share common values and a willingness to cooperate on a common purpose. The following table characterizes the peculiar positioning of the civic sector between the public and private sectors.

**Table 4-3:** The domain of the civic sector

Allocation mechanism→	Public budgets	The market
Criteria of activity↓		
Public interest	Government	<b>Civic sector</b>
Profit	-----	Commercial sector

<sup>9</sup>This definition of citizenship differs from its technical meaning (having legal status as citizen of a given state).

While the public sector depends on political processes and employs legislation and public budgets, the commercial sector uses the market to optimize decisions about production and the exchange of goods. The civic sector, on the other hand, needs reliable information about human needs if it is to satisfy them in areas where they aren't being adequately satisfied by either the commercial sector or government. The civic sector is independent of the government; in this sense, it behaves as the private sector. Its activities aren't motivated by profit but by the desire to satisfy the interests of a specific community; in this sense, it behaves as the public sector. For this reason, a number of authors recommend that the civic sector be referred to as a specific third sector, in which non-profit organizations abide by rules that are distinct from the laws of the market and the functioning of the state and its institutions.

Analysts of civic sector development call attention to the fact that non-governmental organizations tend to operate where neither the market nor the government are effective. Therefore, is it possible to conceive the *raison d'être* of NGOs as a sort of *bypass* of the market and/or government? This is probably true, however, such a definition doesn't fully feature their role. In the long run, NGOs cannot replace the market or government in their primary functions. In many cases, however, they are able to complement them.

Conditions which govern the functioning of the civic sector may significantly support and cultivate or, alternately, mute and destroy the potential of social participation: people's willingness to be involved in formulating social circumstances for the life of the entire society. A more specific distinguishing characteristic is whether a given NGO is engaged in meeting the needs and interests of its own members, or if its activities are oriented towards assisting others by promoting and fulfilling public interests. Naturally, one focus will be predominant over the other. It is difficult to find an organization, which focuses strictly on either public or group interest.

NGOs form an essential institutional framework, which enables citizens to associate and influence public affairs in the role of partners of government and market institutions. Nevertheless, if citizens lack the interest to participate, implementing adequate legislation and economic conditions for NGO activity will not guarantee the development of the civic sector.

Considering the irreplaceable role of the civic sector in the transformation of post-communist countries, a special chapter is dedicated to it (see chapter 7 The Role of the Nonprofit

Sector in Public Policy). At this point, we will only concentrate on the analysis of the regulative functions of this sector in relation to the market and government.

*Advantages of the civic sector*

The civic sector is more effective than the market and government in activities that:

- generate minimal or no profit
- require compassion for the needs of others and a willingness to help them
- require a holistic approach
- provide immediate and sensitive assistance to individuals (day-care, consultancy, assistance to the ill or handicapped)
- assume considerable trust on the part of clients
- require volunteer involvement
- gain financial support through grants
- encompass moral criteria and individual responsibility in the chosen activity.

McKnight (cited in Osborne-Gaebler, 1993:66) presents the following differences between services provided by professionals, on one hand, and those provided by civic associations on the other:

- associations have more commitment to their members than service delivery systems have to their clients
- associations understand clients' problems better than service professionals
- professionals and bureaucracies deliver services; associations solve problems
- institutions and professionals provide "service"; associations provide "care"
- associations are more flexible and creative than large service bureaucracies
- associations are less expensive than service professionals
- associations enforce standards of care they provide more effectively than bureaucracies or service professionals
- associations concentrate on stimulating their clients' dispositions to solve problems; systems of services for providing services that replace the client's own motivation.

In the language of economics, the civic sector is best involved where comparative transaction costs of regulation and execution of the activity would be unreasonably high if the market or government were to intervene.

NGOs, which support public initiative and entrepreneurialship, while searching for ways of covering their own costs, combine the successful characteristics of government institutions with those of a private firm. In this way, they may avoid the failures of both and, therefore, be the most effective institutional alternative. We write "may" consciously, because there is no

guarantee that they won't combine the typical drawbacks of government on the one hand, and the market on the other.

### *Failures of the Civic sector*

The failures of the civic sector are less familiar than those of government. Nevertheless, several characteristic situations where non-profit organizations typically fail have been identified.

Insufficient capacity for dealing with extensive tasks. The informal aspect of the civic sector, which is advantageous in many specific situations, can transform into a disadvantage when it becomes necessary to exert significant and extensive effort from a large number of people. A disciplined and professional public administration, or the strong motive of profit, can be at an advantage in these situations. This failure is, however, more common in smaller, informal organizations while traditional, well-organized non-profit organizations that are less dependent on volunteer work (schools, hospitals, etc.) can successfully avoid such failures.

The absence of civic initiatives where they are necessary. The attraction of the civic sector rests in the involvement of citizens in matters that they themselves consider important. Sometimes, however, their interest differs from that of the general public. If government is too dependent on cooperation with the civic sector, then it could happen that it won't find a suitable partner.

Heightened sensitivity to the personal characteristics of participants. Mutual trust is the cement that connects citizens who take part in the work of civil associations or initiatives. Therefore, interior conflict can be devastating for such organizations. The personalities of the leaders of these organizations pose an especially large threat. They may tend to usurp too much power in their own hands or manipulate the organizations to their own ends - namely in places where control mechanisms are weak or completely missing. NGOs aren't immune to the danger of oligarchy.

Threat of bureaucracy to the activities of NGOs. The means - implementing the programs of NGOs through administration - can be transformed into an end in itself.

Insecurity and instability of the civic sector. Although some NGOs show significant long-term results, in many cases they are fragile institutions with no guarantee that they will survive and responsibly satisfy a significant segment of the public's interests and/or the needs of their clients.

A screen concealing the profit motive. Where NGOs operate in a legal vacuum, i.e. the legal framework for their activities is insufficient or fails to monitor their economic ventures, room for abuse is created. Public good can become a mere front, behind which NGOs hide their illegal profit (for example, tax evasion, paying unreasonably high honoraria), which is comparable to profit from legitimate business activities.

### **Conclusion**

Until now, we have analyzed the market, government, and civic sector individually. We will now attempt to indicate a relationship between the functioning of these sectors. Each characterization of these relationships will limp along somewhat because there have been many contradictory theories, a number of mutually contradictory explanations, and institutional tensions. The only aspect of this issue, which has general validity, is the maxim - stay with the facts, don't succumb to cheap simplifications that are attractive only in their simplicity.

#### *Changes in the relationship between the market and the government*

The past and present offer a number of examples of fluctuation in the relationship between the market, government, and civic sector. Slavery was a very desirable institution from an economic perspective: it pushed the costs of labor down to a minimum. The flipside was the miserable living conditions of slaves. Inequality reigned between them and free citizens and weakened the basic sentiment for justice. The recognition of universal human rights by the state resulted in the abolition of slavery, which had an immediate impact on the prevailing conditions on the job market. Increased labor costs understandably handicapped firms previously profiting from slave labor.

Looking at the industrial evolution of developed countries in the last 100 to 150 years, it is surprising how significantly the role of the state in people's lives has increased in comparison to that of the market.

“The prevailing tendency of development has been to expand public projects. Many unspecified projects gradually gained the characteristic of projects belonging to a specific society or nation, which could not be realized on the market by private persons” (Hendrych, 1992:14).

The public consumption as a share of the Gross Domestic Product of developed countries was continually increasing through the 20th century and currently varies between 30 and 50

percent. Although efforts are being made to explain this development exclusively as the result of subjective political will, it is primarily an objective evolutionary process resulting from the increased complexity of society. The need to provide people with various (public, merit, mixed) goods cannot be left to the free play of the market forces. The processes of industrialization and urbanization have gradually forced the government to organize, finance, and in some circumstances run programs in areas in which the state has not been active at all in the past.

Lindblom considers the possibility of fundamental changes in the role of the market and the state in ensuring greater equality of income distribution among individuals. The hypothetical free market would undoubtedly exacerbate inequality in incomes from salaries, rents, interest, and profit, because each individual could only depend on what he could offer for exchange on the market. However, the effects of the modern market are modified by taxes, public expenditures, and other regulating mechanisms. One can easily imagine a functioning market with a more equal distribution of wealth than what we are used to today. Even the majority of inhabitants both in Western and “new” democracies believes that differences between rich and poor generated within and among contemporary capitalist societies are too high. Some argue that when differences in income are decreased, the motivation for productive work is lost. As a rule, the opposite is true: if it is more difficult to earn additional income, people will work harder. How an individual will truly act, depends on his subjective decision between work and free time, which in turn depends on culture, personality, and many other variables of social and labour organization which either support or mute the motivation to work. The barrier to greater equality of incomes and wealth is not a product of the inner logic of the market. It is a historically inherited and politically maintained inequality of individually held possessions, positions, salary levels, and shares in income. In principle, the government may redistribute income and wealth and repeatedly re-distribute so often as it wishes. The fact that it doesn't tend to act that way needs to be explained politically rather than by looking to the “nature” of market itself.

#### *The market and the government – an uneasy alliance*

Lindblom shows that in various social arrangements, politics and economics depend on each other.

#### **Table 4-4:** Types of politico-economic systems

Political system → Economic system ↓	Democratic	Authoritarian
market oriented	democratic capitalism	market oriented, but without guaranteed human and civil rights
centrally planned	-----	socialist countries

Source: Lindblom 1977:161; modified

A noteworthy discovery! While market societies may or may not be governed democratically, democracies cannot exist without a market. Countries (in fact the majority of countries in the world) that have a market, but in which democratic government and a fully functioning civic sector are still unfamiliar, illustrate that the market isn't an automatic guarantor of democracy:

*"Market economics can coexist with one-party rule. Although reforms leading to the implementation of a market economy may safeguard the existence of specific groups and individual interests, they do not necessarily lead to democracy" (Batt, 1991:33).*

Do any general reasons for maintaining the role of the government in market regulation exist? Ernst Gellner (cited in Musil, 1996:31) comments:

*"Side-effects of unlimited economic activity would destroy everything - the environment, cultural heritage, and human relations. These powers simply must be politically restricted even though the control should be gentle, camouflaged, and negotiated. The economy must be strong enough to create plural institutions, but not strong enough to destroy our world."*

In democratic, market oriented societies, the regulatory role of government isn't at all simple. The government in many ways depends on the private sector. Because public business functions (maintaining employment, prices, production, growth, standard of living, and the economic insurance of individuals) are often performed by private businessmen, the government tends to be indifferent to the methods with which these businessmen achieve their goals. Therefore, businessmen in general, and corporate management in particular, have very high standing in relation to government; a standing which is incomparable to any other group except maybe of civil servants themselves. The risk of government failure grows, as decision makers find themselves bound by interest groups with specific agendas (Mlčoch, 1997).

This contemporary dualism of governing is reminiscent of the medieval dualism between church and state. The relationship between government and business is no less complicated.

Mutual compatibility between the government and business can be found in the following areas:

- the state oversees and regulates entrepreneurial activities
- this regulation is limited by the threat of negative consequences of its implementation which can affect the public functions of business
- the state is also limited in other areas of public policy with regard to the possible negative impact of government regulation on the business sector
- the representatives of business circles actively promote their personal interests in negotiation with government representatives, even resorting to the threat of decreased economic activity if their demands aren't met
- businessmen hold a privileged position, being both passive participants, as well as having an influence over governmental decisions
- the state has the hypothetical authority to deny the for-commercial sector some privileges or even to liquidate a firm or entire business sector.

A noteworthy symbiosis occurs between government and business, in which neither side has an interest in manipulating the basis of the relationship. Although businessmen won't have all their interests met, they will succeed in most.

The functioning of the market won't work without competition. Competition is, however, a form of conflict. No other institution besides the government can create specific control mechanisms for keeping this conflict within certain bounds. If the state fails in this function, this otherwise productive and constructive conflict may escalate to the point of destroying those social ties, which are a condition of market exchange (for example, trust between the participants of the exchange) (Etzioni, 1988). Post-communist countries offer many examples of this danger.

#### *The government and the civic sector*

In principle, the government may take three stances toward the civic sector:

- hinder its creation, eliminate it if it already exists, or make it subordinate
- take no interest in it whatsoever
- stimulate its development and functioning.

The first stance is typical for totalitarian regimes, which attempt to limit the sphere of independent civic life. NGOs are the institutional essence of this independence. The third stance is dominant in those countries (such as the Netherlands), which have no problems with the existence of self-conscious and independent citizenship, and where NGOs have already found their niche.

Legislation governing the creation and activities of NGOs varies in different countries. If the originality of this type of institution is taken into consideration, the legislation can be beneficial. Besides direct financial support drawn from the public budget, the state helps NGOs through tax-breaks applied either directly to the organizations themselves, or to their sponsors in the commercial sector.

Historical context plays a large role in the attitudes of individual states. Europe, with a hundred-year tradition of strong, centralized states is less inclined towards the civic sector than the United States, with a weaker government and a long history of civic cooperation and philanthropy. In Europe, however, states take a much larger role in financing the civic sector than in the USA, where a stronger tradition of support from private sources exists.

The preparedness of the population to carry a portion of public problems on their shoulders through civic sector activity is also important. By doing so, they lighten some of the burden of government and decrease the pressure on the total tax burden. In this way, civic activism "pays off" for the citizens of a given country. The inverse is also true: civic „laziness“ decreases the disposable income of citizens, because the state must take on more responsibility in public matters. This is not only more costly, but also not as effective and goal oriented.

### *The market and the civic sector*

In the relationship between the commercial and civic sector, we find less friction and resentment than if we analyze the relationship of both of these sectors to the government. This is because they are to a certain degree dependent on legislation and other conditions created by the state; firms and NGOs are pushed forward by individual and group initiatives and, in this sense, feel similar restrictions and solve similar problems.

The institution of sponsorship is significant. The commercial sector may, through voluntary contributions, support the activities of the civic sector and, through its choice of recipients of its grants, can take part in deciding which activities will have priority. At the same time, the commercial sector can utilize the fact that it provides this support for its public relations purposes.

When the activities of the civic sector are not suitably regulated by law, and when moral norms are weakened, misuse of this institutional form may be the result. Commercial activity is

seen as generally beneficial and NGOs become a mere cloak for tax evasion and other forms of illegal enrichment.

*The simultaneous use of the market, government, and civic sector*

As is evident from the presented overview of regulators and the relationships between them, their interactions are not without problems. Nevertheless, the available evidence allows us to summarize that:

- each sector has its benefits and drawbacks
- each sector has specific domains of effective activity
- the effectiveness of each sector depends on the extent to which their activities are tuned to each other.

Let us now compare the basic characteristics, pluses, and minuses of regulation, which are typical for each sector. This will allow us to think about the manner in which each sector can complement, support, or on the contrary, weaken or interfere with the others.

**Table 4-5:** Basic characteristics of the public, commercial, and civic sectors

<b>Characteristics</b>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic sector</b>
basic functioning mechanism	government	market exchange	voluntary association
decision makers	administrators, experts, citizens	individual producers, consumers, and investors	leaders and members of organizations
regulator of activity	statutes	price signals and modification of amount	Agreements
decision criteria	political objectives- and the best means of their realization	efficiency- maximizing profit and/or benefit	members interests/public interests
sanctions	state authority with the threat of enforcement	financial loss	social pressure
direction of operation	from the top, down	horizontal contracts	from the bottom, up

Source: Uphoff, 1993 – modified

**Table 4-6:** The qualities of various sectors in providing given services

<b>Criteria:</b>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic Sector</b>
<b>Public Sector Strengths</b>			
Stability	good	poor	average

Ability to handle issues outside of the central mission	good	poor	average
Immunity to favoritism	good	average	poor
<b>Commercial Sector Strengths</b>			
Ability to quickly react to changing circumstances	poor	good	average
Ability to innovate	average	good	average
Tendency to replicate success	poor	good	average
Tendency to abandon the obsolete or failed activities	poor	good	average
Willingness to take risks	poor	good	average
Ability to generate capital	average	good	poor
Professional approach	average	good	average
Ability to take advantage of the economy of scale	average	good	average
<b>Civic Sector Strengths</b>			
Ability to reach diverse populations	poor	average	good
Compassion and commitment	average	poor	good
Holistic approach to problem solving	poor	poor	good
Ability to invoke trust	average	poor	good

Source: Osborne-Gaebler, 1993:347 – modified

**Table 4-7:** Tasks best suited to each sector

<b>Functions:</b>	<b>Public Sector</b>	<b>Commercial Sector</b>	<b>Civic Sector</b>
<b>Best suited to Public Sector:</b>			
General regulation	suitable	unsuitable	depends on context
Policy management	suitable	unsuitable	depends on context
Guarantee of equity	suitable	unsuitable	suitable
Prevention of discrimination	suitable	depends on context	depends on context
Prevention of exploitation	suitable	unsuitable	suitable
Promotion of social cohesion	suitable	unsuitable	suitable
<b>Best suited to Commercial Sector:</b>			
Economic tasks	unsuitable	suitable	depends on context
Investment tasks	unsuitable	suitable	depends on context
Profit generation	unsuitable	suitable	unsuitable
Promotion of self-sufficiency	unsuitable	suitable	depends on context
<b>Best suited to Civic Sector:</b>			

Social assistance	depends on context	unsuitable	suitable
Tasks that require volunteer engagement	depends on context	unsuitable	suitable
Tasks that generate little profit	depends on context	unsuitable	suitable
Promotion of individual responsibility	unsuitable	depends on context	suitable
Participating in the life of the society	depends on context	unsuitable	suitable

Source: Osborne - Gaebler, 1993:348 - modified

### *How to optimize the regulation by the market, government, and civic sector*

In the previous years, there has been a growing consensus between experts of various fields, that the market, government and civic sector play an irreplaceable role in regulating the activities of social actors. It is also necessary to become more familiar with the methods, which would optimize the sectors' effectiveness in the resolution of imminent problems in communities, states, and sub-national societies, and lead to a maturation of their "new partnership". (Brown 1994) These authors are able to draw from the experiences of the past which clearly illustrate that one-sidedness can be deceiving and, at the same time, how human thought and activity can be easily lured onto a path that deviates from the fragile equilibrium between the regulators:

- **Socialism** leads many of its champions from a belief in the meaning of collective happiness to overestimating the role of the government as a guarantor of social justice - with familiar negative impact on human liberty.
- **Neoliberalism (libertarianism)** is a school of thought, which overwhelmingly prefers the market as the sole regulator. In this way it threatens the basic premise of modern, stable societies, i.e. creating and sharing common values, and preserving social cohesion and order.
- **Anarchism**, with its disdain of state institutions and the market, would prefer to see society organized on the basis of pure spontaneity and volunteerism. What institution could be more suitable for this view of society than the civic sector? The problem remains, however, that its existence is dependent on both a functioning market and state.

Historical development isn't usually linear, even if it is partly influenced by the implementation of the previously mentioned one-sided doctrines; it brings fundamental reversals in proportions and reciprocal relations in the implementation of the market, government and civic sector. However, history always leads one-sided solutions (and their protagonists) to their proper limits, albeit for the price of significant destructions and lost opportunities and after decades of

confusion. It can be said that an ideal and universally applicable model of relationships between the different sectors does not exist - and cannot exist.

Uphoff (1993) is one of the authors that is firmly convinced that it is possible to achieve a **positive synergy between the functioning of the market, the government and the civic sector**. In order to transform this hypothesis into a convincing theory, it is necessary to systematically increase our knowledge of how to most effectively apply these alternative, although complementary and co-dependent regulative tools. It is especially important to pay attention to the cultural milieu, legislative and institutional environment, and quality of human resources, all in the context of global evolutionary trends, threats, and development opportunities.

## Sources

- Archer, R. Markets and Good Government. Geneva: United Nations Non-Governmental Liaison Service, 1994.
- Arrow, K. J. Social Choice and Individual Values. New York: Wiley 1966.
- Arrow, K. J. The Limits of Organization. New York: W. W. Norton, 1974.
- Barry, N. "Understanding the Market." In Loney, M. ed. The State or the Market. London: Sage, 1987.
- Batt, J. Economic Reform & Political Change in Eastern Europe: A Comparison of the Czech and Hungarian Experience. New York: Council of Foreign Relations Press, 1991.
- Brown, B. Unbalanced Sectoral Development in the Czech Republic: Democracy and the Civic, Market, & State Sectors. Prague: Charles University, 1994. Unpublished text.
- Drucker, P. Věk diskontinuity. (The age of discontinuity) Prague: Management Press, 1994.
- Etzioni, A. The Moral Dimension: Towards a New Economics. New York: The Free Press, 1988.
- Hendrych, D. Základy správní vědy. (Basics of public administration) Prague: Aleko, 1992.
- Kameníček, J. and Kouba, K. eds. Trh versus plán--půl století sporů. (The market versus the plan--a half century of contention) Prague: Karolinum, 1992.
- Klaus, V. Mezi minulostí a budoucností. (Between the past and the future) Brno and Prague: Jan Masaryk Foundation, Publisher Georgetown and Svoboda, 1996
- Lindblom, C. E. Politics and Markets. New York: Basic Books, 1977.
- Mishan, E. J. Introduction to Normative Economics. Oxford: Oxford University Press, 1981.
- Mlčoch, L. Institucionální ekonomie. (Institutional economics) Prague: Karolinum, 1997.
- Musil, J. "Nový pohled na občanskou společnost." (A new view on civil society) The New Presence 2, no. 1, 1996: 31.
- Myrdal, G. Asian Drama: An Inquiry into the Poverty of Nations. Harmondsworth: Pelican Books, 1968.
- Osborne, D. and Gaebler, T. Reinventing Government. How the Entrepreneurial Spirit is Transforming the Public Sector. Reading: Addison-Wesley Publishing Co., 1993.
- Potůček, M.: Not Only the Market. The Role of the Market, Government and Civic Sector in the Development of Post-Communist societies. Budapest: CEU Press 1999.
- Public Administration and Development. Resumed Fiftieth General Assembly Session. New York, United Nations, 1996.
- Streeck, W. and Schmitter, P.C. Private Interest Government. Beyond Market and State. London: Sage, 1985.
- Streeten, P. "Markets and States." World Development 21, no. 8, 1993: 1281-1298.
- The Future of Voluntary Organizations. Report of the Wolfenden Committee. London: Croom Helm, 1978.
- Uphoff, N. "Grassroots Organizations and NGOs in Rural Development: Opportunities with Diminishing States and Expanding Markets." World Development 21, no. 4, 1993: 607-622.
- Weigle, M.A. and Butterfield, J. "Civil Society in Reforming Communist Regimes." Comparative Politics 25, no. 2, 1993: 1-23.

Weimer, D. L. and Vining, A. R. Policy Analysis. Concepts and Practice. Englewood Cliffs:  
Prentice Hall, 1992.

Potůček, M.: The Uneasy Birth of Czech Civil Society. Voluntas, Vol. 11, No. 2, June 2000, pp.  
107-121. ISSN 0957-8765