

**The Free-Market Innovation Machine
and New Public Management**

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Abstract

This essay on New Public Management (NPM) is inspired by Baumol's recent book about capitalism as the free-market innovation machine. While most studies of NPM are from the micro perspective Baumol calls for a macro perspective. If the free-market innovation machine is capitalism's contribution to society's development, what is the contribution of NPM to the development of capitalist society? Common to the free-market innovation machine and NPM is competition. Following the materialist conception of history, it may be argued that NPM fulfils a dialectical process, by which the capitalist method of competition has been installed in three waves subsequently expanding its validity to all of society. In the first wave competition was installed in the Base and the private sector of the economy (the market). In the second wave, competition was installed in the Superstructure and the selection of representatives to the legislative branch of government (democratic elitism). The third and final wave, NPM, is a synthesis, occurring in the Base and Superstructure simultaneously. In the Base it affects the public sector of the economy, the service provision of the welfare state. In the Superstructure it affects the executive branch of government and public administration.

NPM may therefore be promoted as progress, convergence between Base and Superstructure, the public and private sector. However, it may also be argued that neither the customers of the first wave, nor the voters of the second or the users of the third, will fully enjoy the progress promoted by the NPM. The objections and dilemmas related to them indicate that the future capitalist society will be a convergence of methods but a divergence of output. Competition will be the common method, but in the private sector Base it will be "the innovation machine for miraculous growth", and in the public sector Base, it will be "the price variable for downsizing government".

Introduction

This essay on New Public Management (NPM) is inspired by Baumol's recent book, *The Free-Market Innovation Machine: Analyzing the Growth Miracle of Capitalism* (2002). Its topic is illustrated by two introductory quotes, the first from the *Communist Manifesto*, where Marx and Engels stated that the bourgeoisie, i.e. capitalism, "cannot exist without constantly revolutionizing the instruments of production" (Marx & Engels 1848), and the second from *Capitalism, Socialism, and Democracy*, where Schumpeter said that "as soon as quality competition and sales effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position" (Schumpeter 1942). Baumol's motive in writing his book was an assertion that the analysts of capitalism pay too little attention to these observations and too much attention to the price variable. "Prices and directly related variables are still at the heart of microeconomics, while the theory of innovation remains in the outskirts" (p. 7). Baumol's business was therefore to reinstall the free-market

innovation machine as the foremost feature of capitalist economy. What separates capitalism from other economies is not cost saving efficiency, but innovation leading to continuous improvement and growth.

New Public Management is beyond the scope of Baumol's book. For him it was sufficient to analyse the state's contributions to the capitalist growth miracle, as protector of the rule of law and the sanctity of property (p. 68-70). However, his idea of the free-market innovation machine as the hallmark of capitalism is a challenge also for the NPM, as the latter is inspired by capitalist ideas of efficiency and customer satisfaction. The challenge is to assess the relevance and significance of the free-market innovation machine for the NPM approach to governance.

Most studies of NPM are from the micro perspective, from within and below, with the future of governing (Peters 2001) as the dependent variable. The challenge presented by Baumol, however, calls for a macro perspective. If the free-market innovation machine is capitalism's contribution to social development, what is the contribution of NPM to the development of capitalist society?

The macro perspective inevitably updates the analysis of Miliband, whose aim was to understand the role of the state in what then appeared as "late capitalist society" (Miliband 1969). And it updates the analysis Marx and Engels made of the state in early capitalist society, cf. another famous quote from the *Communist Manifesto*: "The executive of the modern State is but a committee for the managing of the common affairs of the whole bourgeoisie".

The Free-Market Innovation Machine

Baumol views capitalist economy as a machine whose primary product is economic growth. It owes its unique effectiveness to the fact that innovative activity is mandatory, a matter of life-and-death for the firm, and not fortuitous and optional as in other economies. Most important for the growth miracle of free enterprise are oligopolistic competition among large, high-tech business firms, with innovation as the prime and price as only the secondary competitive weapon, routinization of innovation, entrepreneurship devoted to

productive innovation, the rule of law, and technology selling and trading. Baumol underlines that capitalism is unique not in invention but in innovation, a point made also by Landes in his attempt to explain why some nations are rich and others so poor (Landes 1998). Other cultures, like Medieval China and ancient Rome, rivalled capitalism in terms of inventions, but as Baumol notes, "most of them proved to be dead-ends in the absence of a systematic innovation mechanism capable of ensuring that they would not languish" (p. 10).

Particularly in the oligopolistic and high-tech sectors of the economy, "innovation has become the preferred competitive weapon. Indeed, the contest for better new products and processes becomes an arms race," (p 11) and firms that let their rivals outperform them in the innovative process of adapting to consumer desires, are "faced with the prospect of imminent demise" (p. 10). The need for innovation leaves the firms with the choice between the risk of not innovating and the risk of investing in failures, as innovation is largely an unpredictable process. The solution is to routinize corporate innovation. Firms are driven to make innovation an accustomed and predictable procedure supplementing the occasional output of genius at work. And innovations stimulate further innovation - in the same or related sectors, in sectors where they serve merely as inspiration sources. "In sum, innovative activity can be considered a cumulative process, in which there is feedback from one innovation to the next; once the free market has launched its innovation machine, the inherent structure of the mechanism leads the machine to grow more powerful and productive with the passage of time" (p. 12).

Capitalism is driven by self-interest, by the profit motive or "greed harnessed to work as efficiently and effectively as it can to serve the public interest in prosperity and growth" (p. 15). The institution ensuring that greed is serving these purposes is *competition*. The invisible hand of the market prevents the greedy "merchants and manufacturers" from deriving excessive profits and forces them to strive provide customers with a better product on better terms than their rivals are offering. Baumol quotes Adam Smith: By pursuing his own interest the producer frequently promotes the interest of the society more effectively than when he intends to promote it.

Baumol is aware that economic growth does not solve all problems for the society (2002:15n13). It solves problems that are dependent on and not incompatible with economic growth. According to Simon (1977) a problem is the gap between the existing and the desired state of affairs. Problem solving is filling the gap. "Movement in the direction of a higher, better, and more desirable state of affairs" is *progress*, Reisman says in his manifesto for laissez-faire capitalism (Reisman 1996:106). Hence capitalism is not merely producing growth, a morally neutral term "equally capable of describing a negative as a positive" (Reisman op. cit). Growth is quantity; progress is quality. Capitalism is producing both growth and progress.

New Public Management

New Public Management is a reform movement rather than an administrative theory. The concept of 'movement' is political, and NPM is hardly different from other movements pursuing a combination of their self-interest and what they consider is best for the society as whole. NPM may be seen as an *ideological* movement, cf. Olsen's observation of three waves (in the perspective of this essay we may call them microwaves) that have subsequently challenged the Nordic welfare state: the red wave of the 1960's and 1970's, the green wave of the 1970's and 1980's, and the blue wave of the 1980's and 1990's (Olsen 1986). NPM may also be seen as an *administrative* movement, practitioner-driven (Borins 1998), which confirms that public administrations are political actors themselves and not merely neutral instruments for the democratic political will (cf. Niskanen 1971). And NPM may be seen as a movement within *administrative research*, a new philosophy for the administration of public affairs, confirming that administrative research is social engineering. The latter seems to describe its origins rather well (Barzelay 2002), and is reinforced by the fact that a stated intention is to copy managerial methods from the private sector, where scientific management has long traditions (cf. Taylor 1911).

Competition

The institution that is common to the free-market innovation machine and New Public Management is *competition*. Peters (2001), who sees four models emerging from the current attempts to reform Old Public Administration, subsumes NPM under the market

models of reform. "There really is no single market model, other than the basic belief in the virtue of competition and an idealized pattern of exchange and incentives" (Peters 2001:24). The inaugural NPM article of Hood (1991) had competition as one of seven doctrines for public management. Osborne & Gaebler (1992) reinvented government by making "most entrepreneurial governments promote *competition* between service providers". Their book inspired the National Performance Review of the Clinton administration, where step one in putting customers first was giving customers a voice and a choice, and step two was making service organizations compete (Gore 1993).

Competition as ideology links NPM to the history of economic and political thoughts and the subsequent development of society's institutions. In order to understand the connection between the free-market innovation machine and NPM we may turn to Marx and the materialist conception of history, as developed particularly in *The German Ideology* (1970 [1846]). Here Marx explained how the economic system of a society determines its total operations. Using the well-known materialist framework of Base and Superstructure, we see how the capitalist method of competition has been installed in three waves subsequently expanding its validity to all of society.

The first wave, Baumol's topic, we associate with Adam Smith and *The Wealth of Nations* (1776). In this wave competition was installed in the Base and the private sector of the economy, where the market is the main institution. Competition is here intended to serve the interests of the *customers*. The main challenge is to prevent the establishment of market monopolies.

In the second wave, competition was installed in the Superstructure and the selection of representatives to the legislative branch of government. In democratic elitism (Bachrach 1967), the competition between political parties is similar to the competition between firms in the market. We associate this wave with *Capitalism, Socialism, and Democracy* by Schumpeter (1942) and *An Economic Theory of Democracy* by Downs (1957). Competition is here intended to serve the interests of the *voters*. The main challenge is to prevent the establishment of one-party power monopolies.

The third and final installation wave for competition as society's engine is in this context *New Public Management*. As foreseen by the dialectics of historical materialism it is a synthesis, occurring in the Base and Superstructure simultaneously. In the Base it strikes the public sector of the economy, the service provision of the welfare state. In the Superstructure it strikes the executive branch of government and public administration. We associate the wave with *A Public Management for All Seasons* by Hood (1991), *Administrative Argument* by Hood and Jackson (1991), and *Reinventing Government* by Osborne and Gaebler (1992).

The third wave affects a sector where the monopoly has been taken for granted. In the Superstructure it affects the ultimate executive power of the society. In the Base public monopoly was considered the only feasible solution when the service provided was a public good impossible to finance by other means than taxes. It seemed necessary for the exploitation of limited resources, as the only and unacceptable alternative was a private monopoly. It seemed preferential for services that the majority wanted rendered according to need, irrespective of purchase power, implying that the market mechanism was rejected for reasons of equality and justice.

In the third wave competition is intended to serve the interests of the *users* (re-baptized from clients to customers when served by the commercialised public sector's Base). The main challenge is not to prevent monopoly, but to break up existing monopolies. In the Base this implies the introduction of real competition. In the Superstructure it implies means that *resemble* competition. "Many of government's functions are public responsibilities precisely because the private sector cannot, should not, or would not manage them. But we can transplant some aspects of the business world into the public arena. We can create an environment that commits federal managers to the same struggle to cut costs and improve customer service that compels private managers" (Gore 1993).

In the temporal perspective of public governance, the transition "From Old Public Administration to New Public Management" (Dunleavy & Hood 1994) appears as a revolution (Olsen 1986, Kettl 1997, 2000). In the spatial perspective of capitalist society, however, it merely implies that the output side of the public sector is catching up with the rest. Marx was preoccupied with the *horizontal* cleavage of capitalist society, its division

into bourgeois and proletariat, to the extent that some accuse him of "wholly overlooking the fact that bureaucracy is one of the central phenomena of modern political and socio-economic life" (Avineri 1976:49). NPM is concerned with the *vertical* cleavage of capitalist society, its division into a public and a private sector with distinctly different cultures and economies. The vertical cleavage has attracted interest from students of employment and work values (e.g. Baldwin 1991, Emmert & Taher 1992, Crewson 1995, DeSantis et al 1996, Karl & Sutton 1998, Norris 2003) as well as of electoral behaviour (e.g. Hoel & Knutsen 1989, Blais et al 1990, Iversen & Wren 1998).

Slagstad has given a vivid description of the Norwegian vertical cleavage during the many post-war years of undisputed Labour party reign (Slagstad 1998). Fifty years ago the horizontal cleavage battle between labour and capital ended with an ideological compromise, the joint socialist and bourgeois project of welfare state and welfare capitalism. The Labour Party State was based on a balance of power between labour and capital, with socialism dominant in the political system, slightly modified by capitalism, and capitalism dominant in the economic system, slightly modified by socialism. It was a compromise in governance between two logics, that of democratic justice and market economic effectiveness, and a dual power system, one public and one private, with Labour dominating the public and the bourgeoisie dominating the private. In the dual power system, the public and the private sectors were two separate power circuits with their own norms, values, persons, and dynastic tendencies. The dualism was coordinated via corporative arrangements, where the leaders of labour and capital in the private sector met under the auspices of the Labour prime minister (Rokkan 1966). The coordination was achieved through "negotiate economy and mixed administration" (Hernes 1978), based on the partnership between economic and political elites (Bull 1984). It was a comfortable arrangement for both power circuits, but like other comfortable arrangements under socialist auspices - as in Middle and East Europe - it congealed. By the end of the 1970s the dual corporative-technocratic system of governance had nothing more to offer. The era of the Labour Party State was over.

NPM as Progress

The NPM movement has struck countries at all levels of economic development (Borins 1998). However, from the perspective of the stage theory of growth (Rostow 1960, Østerud 1978), it is of particular interest for the post-industrial society (Bell 1973) and the information age (Castells 1996, 1997, 1998), in which direction the countries are all heading. According to the National Performance Review, the "root problem" of Old Public Administration is "industrial-era bureaucracies in an information age" (Gore 1993). Thus the NPM provokes us to question Bell's assertion (1980:505) that the axial principle of the information society is codification of theoretical knowledge. Admittedly "information and knowledge are the crucial variables of post-industrial society", just as capital and labour were "the central variables of industrial society" (Bell 1980:506), but this does not make them axial. As noted by Baumol (2002:13n11) and others, investments in human capital were substantial in the Soviet Union, but still the system was unable to produce growth that its inhabitants would regard as progress (Baumol 2002:20). Furthermore, NPM provokes us to question the assertion of Castells (1996), that the post-industrial society of the information age is essentially a network society. Admittedly networks are important for growth; indeed one reviewer of Landes' *Wealth and Poverty of Nations* (1998) maintains that Landes' single key to success is openness (De Long 1998). However, the value network is only one of three configurations for creating growth, the others being the value chain and the value shop (Stabell & Fjeldstad 1998).

Finally, NPM offers another perspective on progress than Olson in *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships* (2000), and Przeworski et al in *Democracy and Development: Political Institutions and Well-Being in the World* (2000). Their topic is democracy as a condition for economic growth; i.e. an independent variable leading to a dependent variable which is also a more desirable state of affairs. In instrumental terms, their point of view implies that democracy is merely a value in the political means variable, and growth is the desired value in the economic end variable, which is the ultimate goal for development.

The approach suggested by Olson, Przeworski and others is subject to the criticism made by von Wright in his essay on the *myth of progress* (Wright 1994). According to this

Finnish philosopher, our ideas of progress, as the perfection of humanity and society on one hand, and as accumulation of knowledge and technical improvement on the other, have both suffered from reification, precisely because we identify them with formalization of democracy and economic growth. Instead of government by the people we have got a set of formal procedures for being governed. Instead of progress we have got growth. The only valid measure of progress is the well being of humanity given the circumstances under which people live, von Wright says.

NPM has the potential to avoid this criticism and provide an answer. As a political reform movement NPM must be a goal in itself, for which macro-economic growth may serve merely as an argument to gain support. This reversal of means and ends seems to underlie the analyses of Hood (1996, cf. Flynn 2002:60), incidentally indicating that economic conditions make no difference for the implementation of NPM, a conclusion sustained by Borins (1998) and the fact that social-democratic parties implement NPM reforms with the same enthusiasm as do liberals and conservatives (Tranøy & Østerud 2001:31). In fact, it may even be argued that NPM has elements threatening economic growth as a goal. Ever since Adam Smith it has been clear that the free-market innovation machine requires the rule of law, cf. Baumol above. NPM is obviously not advocating the return of Olson's *roving bandits* (2000), but a major aim is to change from rules to missions as guiding principle for public action, and from general rule application to individual discretion as a major component of the method for decision-making (cf. Hood & Jackson 1991, Osborne & Gaebler 1992, Christensen & Lægheid 2001b). Decentralization of power, entrepreneurial leadership, and increased freedom of choice for decision-makers shall increase the effectiveness of the bureaucracy (cf. Pollitt & Bouckaert 2000). This may well solve problems for the public sector, but at the expense of a private sector depending on the bureaucracy's fairness, predictability, and stability.

The proponents of NPM may therefore safely abstain from arguing in causal economic-administrative terms. Instead they may promote NPM as *convergence*. They may describe it as convergence in the sense that public administration and civil service systems become similar¹; as convergence adding a dimension to the theory "that as rich countries got richer,

¹ For sceptical and critical reviews of the ideological movement's charge to promote conversion into its belief, see Lynn 1998, Christensen & Lægheid [ed.] 2001.

they developed similar economic, political, and social structures and to some extent common values and beliefs" (Wilensky 2002: 3). They may promote it as convergence resulting in the Base and the Superstructure, the Private and the Public, the Market and Politics, Democracy and Administration all sharing the values of capitalism, and producing decisions, goods and services according to its principles. They could argue that NPM completes the transition - led by an invisible hand - from a capitalist economy to a capitalist society, where all activities revolve around one axial principle, not the codification of theoretical knowledge (Bell), nor the information network (Castells), but the universal method of *competition*.² In this society there is one common system for social, political, and economic development. Its products are the innovations; its progressive mode is evolution. Other systems can produce greater *inventions* leading to giant paradigm shifts (Kuhn 1970). However, in systems where further innovation is not mandatory, the accidental revolution may be followed by stagnation or even setback. Capitalism, too, has had its crises, and a major theory suggests that it will repeat itself in cycles (Schumpeter 1939). But the free-market innovation machine will keep on rolling, and the tortoise of constant evolution will triumph over revolutionary systems. This convergence the proponents of NPM may call *progress*.

NPM provides an answer also to the challenge from von Wright. It recognizes that the only judge of human progress is human kind itself - the customers, voters, and users - and that the only valid measure of progress is the well-being of the people given the circumstances they live under - the "welfare regimes" (Esping-Andersen 1990). Von Wright's definition of progress echoes the "greatest happiness for the greatest number" utilitarianism of Bentham in his *Introduction to the Principles of Morals and Legislation* (1973 [1789], cf. Troyer 2003). Modern economic theory is essentially utilitarian (Warke 2000), and NPM puts it to work in public administration. Capitalism is a machine for progress, even in the service industries, even in the public sector.

² This replacement would probably please Wilensky, who concluded his search for empirical evidence with the proposal "Let's drop 'Post-industrial Society' from our vocabulary" (Wilensky 2002:205).

Objections and dilemmas

There are of course many objections to the idea that the free-market innovation machine is producing progress. Consider the *customers* of the First Wave. Capitalism takes their potency for granted; its opponents take their impotence for granted. The Norwegian power analyst Hernes (1979) has summed up the contrast: The potent consumer of capitalist economic theory is sovereign, fully informed, calculating, stable, mighty, cooperating, demanding, equal, and responsible. The impotent consumer requiring political protection is easily manipulated, without overview, uncertain, labile, frail, counteracting, unable to express demands, unequal, and unable to take responsibility.

Consider the *voters* of the Second Wave. The idea of democracy as a competition between political elites, with the citizens as bystanders occasionally called in to serve as grand jury, has been criticised by the adherents of participatory (Pateman 1970, Berg 1983), deliberative (Cohen 1991, Habermas 1982, Weigård & Eriksen 1998), and communitarian democracy (Etzioni 1996, 1998). Von Wright denounced it as a reification of true democracy where all citizens participate in its creation and maintenance (1994).

What then about the *users* of the Third Wave. Are they more certain of their fortune? Perhaps the most frequent criticism of New Public Management is its one-dimensionality (Christensen & Lægveid 2001a: 67 and 2001c), "the constant economic rationalisation of all activities" (Greve & Kragh Jespersen 1999:146). The ideal objective of NPM is well described by the title of US Vice President Al Gore's report on the National Performance Review: To create a "Government that Works Better and Costs Less" (Gore 1993). However, what if the two goals are irreconcilable? What if governments must choose between working better and costing less, in Baumol's terminology between the free-market innovation machine and the price variable? "There is widespread belief that firms should pursue superiority in both customer satisfaction and productivity. However, there is reason to believe these two goals are not always compatible" Anderson et al write in a study concluding that "the association between changes in customer satisfaction and changes in productivity is positive for goods, but negative for services" (Anderson et al 1997: 129). Cohen presents a similar view in *Our Modern Times*: What halts the revolution of the Information Age is the cost-saving efficiency demanded by financial capital (Cohen 2003).

Conclusion

New Public Management has been interpreted as a means to re-set the pace of growth in an economy hampered by a swollen and inefficient public sector, and a major strand is concerned with downsizing government for that reason (Pierson 1994, Ferlie et al 1996, Peters 2001, Mørkved 2001). When forced to take a stand, NPM clearly gives priority to the Cost Less objective (which also is a major impediment against obtaining general support for NPM reforms, Kelman 1990, From & Kolberg 2003). The movement's main justification is the alleged crisis of legitimacy of the welfare state, caused by increasing taxpayer expectations and decreasing willingness to pay. In this perspective even Continuous Quality Improvement, a stated innovative goal of NPM, must serve to cut costs and reduce government size and impact (Peters 2001, Glor 1999 discussing Peters 1996). It is a means to an end for the producer, not the consumer. "Experts link customer satisfaction decline to downsizing" (Struebing 1997: 17) is a lesson drawn from the American Customer Satisfaction Index (ACSI).

Among others Kuhnle (2000) and Wilensky (2002) are disputing that there is a crisis of the welfare state. From this point of view, NPM is seen as a means without an end, a rebel without a cause. And conversely, if NPM is to board Baumol's free-market innovation machine, the movement must itself call off the crisis of the welfare state and stop downsizing government. For ideological movements pursuing the power and prestige of its adherents, such a casting of means and ends is not exactly uncommon.

Unless NPM undertakes this casting, objections and dilemmas like these indicate that the future capitalist society will be a *convergence of methods* but a *divergence of output*. In the private sector Base competition will be "the innovation machine for miraculous growth". In the public sector Base, it will be "the price variable for downsizing government". To some that will be progress. They could even seek support from Marx and Engels, who probably would agree that the bourgeoisie would be in a better position to constantly revolutionize the instruments of production when paying for only a small executive committee to manage their common affairs. To others it confirms the gloomy view of von Wright, that progress is a myth. They could count on his support when stating that competition improves some, but not all circumstances leading to a good life.

About the Author

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