

Policy Framework¹



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<http://indiapolicy.org/>

The following ten questions ask for evidence-based information about the nature of a policy issue in the unregulated free market (absence of government), any role for government in 'resolving' the identified issue/s, and (if so) how a government can effectively deliver such role. By addressing these questions, a policy's logic and assumptions become clear.

First order, second order and third order functions

These terms have a specific meaning for IPI. First order functions include foundational roles of a government (defence, police, justice). Second order functions may be undertaken after first order functions have been performed well, and include things like some infrastructure and social minimum. IPI believes a government should not undertake any other (third order functions) unless there are extremely compelling reasons to do so.

1. What would happen without any role for government

- Assume the existence of a limited government which looks after security, police and justice and ensures the rule of law (including enforcement of private contracts).
- Imagine the entirely free market – i.e. without any law, regulation or subsidy for this policy area (not even licensing or registration). People freely implement their plans, and their contracts and agreements are enforced. This was typical of most activities in the past, and forms the base case. The general policy design principle is that any government intervention (Q.4) must do as well or better than the base case.
- Use historical literature or theory to explain what would happen in such a situation.
- Consider buses, for instance. In the past there was no regulation of buses, which led to a specific competitive outcome (see Daniel Klein's *Curb Rights*). Or consider school education. In the absence of a role for government, children of the poor might not get high quality education. Or infrastructure might be under-supplied.

A base case often discloses specific weaknesses in incentives that form part of the free market. The competitive failure in buses, for instance, originates from the failure of society to define a particular property right (in bus stops). Analysis of the specific causes of any problem/s or weaknesses in the base case is considered in Q.2.

Note:

For first order functions of government: For policies relating to the core (or first order) functions of government (such as defence and justice), the equivalent to Question 1 becomes: "What would happen in the **absence** of government (state of nature)?"

It can usually be demonstrated that it is beneficial for government to play some role in

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these core policy areas.

But such role need not involve direct management. Even police, prisons and justice system can benefit from innovative market-based approaches that use incentives effectively to help society achieve a cost-effective defence, policy and justice system.

2. Identify problem/s with the base case and explain why these are problems

- Identify any problem/s with the “without government case”. This should be done as precisely as possible. Evidence should be adduced to demonstrate that such problems actually arise. Discuss the magnitude of any such problems.
- Thereafter identify the likely causes of these problems. The competitive failure identified in the bus market originated from a failure to define a particular property right (in bus stops). Such analysis will lead to possible options for solving the problem (Q.4).
- Explain why free citizens through their individual voluntary actions (market) can’t resolve these identified problems (e.g. through self-regulation).
- Retain for any further analysis (Q.3 and beyond) only *real* problems identified in Q.2 that citizens are demonstrably unable to resolve on their own.

3. First principles test

- Examine the issues or problem/s identified in Q. 2 using the framework of liberty. This can involve asking whether the problem/s invoke any first order or second order function of the government.
- IPI’s vision provides guidance about issues in which government should have a “first principles” role (the so-called core or first order functions), and issues in which a government should (ideally) stay out unless absolutely necessary (some second order functions, and almost all third order functions).
- If the problems identified in Q.2 do not fall in the first two categories, then explain why a government would need to consider these problems.

4. Options: What can government do about the problem/s?

- Assuming that a government can potentially play a role in dealing with the problems identified in Q.2, what can such government do to (potentially) solve them?
- List the full range of options available to a government, from most onerous (for citizens) to least onerous, to address such problems. For instance, a light-handed option to solve the competition failure in the bus market might involve clearer allocation of property rights (e.g. for bus stops). The heavy-handed option would include direct ownership and management of buses by government.
- Heavy handed options are generally based on socialist ideas or a belief that bureaucrats know best for us: the people. Philosophies of liberty shun heavy-handed approaches and look for market- and incentives-based solutions. In particular, they are fundamentally opposed to the government being a businessman. A way must be sought to regulate the market, if any serious problem has been identified. Direct management by government of any sector that can be potentially privately managed through good

regulation is anathema to the free citizen. Even where supply of infrastructure is involved, there is no direct implication that a government should provide it. Wherever possible, users must pay for any service not used equally by all citizens.

- Which of these options can potentially work better than the base case (free market)?
- To what extent do each of these policy options allow markets to determine supply, demand, and prices? The more the market testing of any relevant prices, the better.
- If a proposed option involves administered prices (e.g. for petrol/ education: we must look askance at any such policy), then by what objective mechanism will the government assess actual demand and supply? And how will it respond to changes in these variables as well as the price system?
- If no option can demonstrably do better than free citizens acting voluntarily on their own accord (free market), the proponent should stick with the base case (Q1) as the best policy option. Remember, the base case is always the first option on the table.
- If the proponent chooses the base case (free market) as the best option, go straight to Q.10.

5. Freedom test

- Assuming the proponent has found a policy option that does better than the base case, does it reduce anyone's freedom? If so, whose? How? And why? Note that taxation, being coercive (even if agreed through the legislature), is a reduction in freedom. Therefore, any attempt to subsidise something must be fully justified. IPI does not accept any redistributive role for government, taking money from A to subsidise B.
- If a particular policy option reduces freedom, explain why it is desirable or necessary to do so. This may be necessary if freedom could lead to significant harm. In such case, the broader gains to law-abiding citizens from reducing someone's freedom may be overwhelmingly greater than the costs imposed on them by an unregulated market. But this has to be conclusively proven.
- It is unacceptable to reduce freedoms for a large group of people to address harm caused by a few. And, of course, it is entirely undesirable to reduce freedom purportedly for someone's own benefit. ("That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not sufficient warrant" – JS Mill.)
- If the proposed option/intervention is unable to comprehensively justify any restrictions it imposes on liberty, then it should be dropped, and the free market (base case) (Q.1) chosen. The proponent can then go to Q.10.

6. Strategic gaming test

Instruction:

- Assuming the proponent has identified an option that gives government some role but does not reduce freedoms unnecessarily, now imagine such policy has been implemented.
- The proponent should put himself in the shoes of businesses and consumers. Imagine all possible ways by which businesses or consumers can game the system (i.e. how they will take advantage of any loopholes). Identify the (unintended) consequences of such

policy failures.

- A usual unintended consequence of bad policy (typical of India's policy regime) is the significant moral decline of society, as people think of new ways to cheat government through tax evasion, bogus ration cards, or excessive use of "free" government services. Distortions of work incentives are another typical aspect of strategic gaming. Think of the policy design process as a game of snakes and ladders. Each time the proponent think he has solved the problem, someone with a sharper mind (usually the common citizen) can unravel all plans.
- Given this challenge, how will the proposed policy prevent any unintended consequences?
- Since badly designed policy will often lead to far worse outcomes than the base case, the proponent should, in such a case, revert to the base case (Q.1) and proceed to Q.10.

7. Government failure test

- Public choice theory (and common experience) confirms that most bureaucrats perform indifferently and many shirk work. (This is apart from any tendency for corruption, well documented by Chanakya.) They are often lazy thinkers, indulge in group think, tend to hide the truth about their real performance from citizens and elected representatives, and strategically outwit any audits or evaluations of their work. They also tend to perform very poorly compared with their counterparts in the private sector, often at double or greater cost. The reason for this typical behaviour of all bureaucracies (known as government failure) is simple: that *all* people are less diligent about spending other people's money (in this case, taxes) than they are about spending their own money.
- Assuming that the proposed policy (a) identifies a role for government, (b) does not reduce liberty unnecessarily, and (c) is robust to strategic gaming by citizens, now describe how it will overcome the ever-present dangers of government failure.
- In particular, what independent scrutiny of implementation of the proposed policy is part of the proposed policy design? How will citizens know whether the proposed policy is actually working, or they are receiving fake reports about incompetent outputs at inflated costs?
- Also, how will the proposed policy avoid regulatory capture? [This forms part of strategic gaming (Q.6), but can involve strategic gaming by government functionaries as well.]

8. Real experience test

- The potential policy is now looking good, having crossed many hurdles. Just two remain.
- First, has such (or similar) policy been implemented anywhere else? If so, what was the actual experience? What gaps and shortcomings were identified? This needs to be researched carefully, since IPI members should know about any *actual* risks of a proposed policy.
- How will the proposed policy address these and similar gaps during implementation? There is no "poor implementation". There is only poor policy.

9. Cost benefit test

- It is desirable (not mandatory) at this stage to provide a detailed theoretical economic model to underpin the policy logic. With this, there now exists a *prima facie* theoretical basis and practical evidence that the proposed policy is desirable.
- The last hurdle the proposed policy must cross is to prove that it will actually provide a net benefit to India. In this step the proponent should identify key costs and benefits of the proposed policy. Cite real evidence to prove that asserted benefits are real, not imaginary or inflated. Such utilitarian analysis (cost/benefit) can provide useful insights *after* the analysis of liberty and other issues has provided justification for such policy.
- Where net benefits can be quantified, quantify them. (Detailed Net Present Value calculations is generally needed, at this stage.) Proponents should document their assumptions clearly. It should be proven beyond reasonable doubt that benefits exceed costs, citing appropriate evidence and data.

10. Transition path

- So far the policy the proponent has identified was hypothetical. India has no “good policy”, so it is unlikely that the policy identified in Q.9 is being implemented anywhere in India. This leads to the need to design transitional arrangements from the current Indian system to the proposed policy system.
- Under this question, key transitional arrangements that will allow the proposed policy to be implemented successfully should be discussed. In doing so, the proponent may ask questions such as:
 - Is it possible to phase-in the introduction of the proposed policy or does it require a sudden break from existing arrangements?
 - Who are the policy’s key stakeholders?
 - Are there any obvious political constraints to implementation of this policy?
 - Who might lose from this policy (e.g. people whose property rights might be reduced or whose chances of making money through corruption reduced)?
 - Who will oppose the proposed policy (might include losers, but also interest groups misinformed by the losers)?
 - How can opponents to the policy be brought on board (e.g. through compensation, persuasion)?

At the end of this analysis, the policy should be summarised, and this detailed analysis appended for public consultation/ discussion.