

# Policy Framework

## A guide to policy making

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<http://indiapolicy.org>

This policy framework provides guidance on how IPI considers policies.

The ten questions in this framework seek evidence about the nature of a policy question or problem in an unregulated free market (not necessarily in the absence of government), any role for government in ‘resolving’ the identified problems, and (if so) how a government can effectively deliver such role. By addressing these questions, a proposal’s logic and assumptions become clear – enabling any shortcomings of analysis to be identified and potentially overcome.

### Defining first, second and third order functions

These terms have a specific meaning for IPI.

**First order functions** include the foundational roles of a government (defence, police and justice).

**Second order functions** include things like some infrastructure and support for equality of opportunity, including elimination of dire poverty through a social minimum. These functions may be undertaken but only after a government has performed its first order functions well enough.

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 involvement of the government?

- Assume the existence of a limited government (which looks only after defence, police and justice and ensures the rule of law, including enforcement of private contracts): not the absence entirely of government.
- Imagine that the free market applies to this policy area, i.e. there is no law, regulation (e.g. no licensing or registration) or subsidy applicable to this policy area. People are therefore able to freely implement their plans and the role of the government is limited to enforcing contracts and agreements. This may be an unusual situation to visualise today in many policy areas but it is how almost everything evolved in the past. Governments did not operate industry, schools or hospitals; or even build roads, supply water or electricity.
- This situation forms the base case. The general principle of policy design is that any government intervention (Q.4) must deliver “as good or better” outcome for society than this base case.
- In the absence of current evidence for such a situation, **use historical literature or economic theory** to describe what would happen in such a situation. For schools, for instance, James Tooley’s book, *The Beautiful Tree*, confirms that prior to government intervention, schools functioned cost-effectively and delivered superior outcomes. The argument that in the absence of the government’s involvement, the children of the poor might not get high quality education is only partially supported by such evidence.
- The argument that infrastructure might be under-supplied in such a situation is also very poorly supported by historical evidence (e.g. Walter Block’s study of roads). In fact, in France, even today 76% of the total roads in France are operated privately; likewise, trains are operated

privately in Japan. And in the USA electricity was almost never supplied by the government. Even nuclear reactors are privately managed. There is therefore no natural basis to claim that infrastructure must be provided by the government. In any event, once property rights can be defined, the market can readily deal with infrastructure provision through user charges and price discrimination.

- But there is some evidence that in the absence of regulation, some areas might fail. We know that under certain circumstances, large buses can be displaced by small buses which then lead to traffic congestion. But this outcome is not innate to the situation and is attributable to the failure of society to define a property right in bus stops (see Daniel Klein's *Curb Rights*).
- Analysis of the specific causes of any problem/s or weaknesses in the base case is considered in Q.2.
- Waving one's arms about and claiming that everything would fail in the absence of government will never be accepted by IPI. There need to be strong proofs of failure.

**An exception for first order functions of government:** For policies relating to first order functions (e.g. 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 in such a case that it is likely to be beneficial for the government to play *some* role. But such role need not involve direct management and control by the government. Even the police, prison and justice system could potentially benefit from market-based incentive-compatible approaches to achieve a cost-effective defence, policy and justice system. How do we know how much defence or police is enough? How do we ensure cost-effectiveness? There needs to be a critical examination of all policy areas.

## 2. Identify any problems with the base case and explain why these are a problem

- Identify any market failures or other problems with the situation in base case, i.e. the case "without government (or with limited government)". This analysis should be very precise. Evidence should be adduced to demonstrate that such problems actually arise. Also discuss the magnitude of any such problems.
- Next, identify the likely cause of these societal problems. For instance, we saw above that the failure of competition in the bus market actually originated from a failure to allocate property rights (in bus stops). Such analysis can lead to effective options for solving the problem (Q.4), instead of waving one's arms about and jumping to the conclusion that the government must own and manage all buses.
- Explain why free citizens through their individual voluntary actions (the market) can't resolve these identified problems (e.g. through self-regulation, through reputational effects).
- Retain for any further analysis (Q.3 and beyond) only the *actual* problems identified in Q.2 – problems that citizens are demonstrably unable to resolve on their own.

## 3. First principles test (should government intervene at all?)

- We noted above certain "first principles" roles for the government. There is an assumption that a government should perform certain core or first order functions.
- Likewise, there is a clear area in which a government should stay of, unless absolutely necessary. This would include some second order functions and all third order functions.

- If the problems identified in Q.2 do not fall in the first or second order functions, then it is crucially important in this step itself to demonstrate why this problem needs to be considered further. In many cases, the matter will end at this stage itself.

#### 4. Options: What exactly can government do about the societal problem?

- If it can be shown clearly that there might be a possible role for the government in dealing with the problem/s identified in Q.2, what exactly can the government do?
- In this section of the analysis, list the **full range of options**, from most onerous intervention to least onerous. A light-handed option to solve the competition failure in the bus market might involve a law that allocates property rights in bus stops. The most heavy-handed option would involve direct ownership and management of buses by the government (sadly, that's the answer most poor quality analysts end up with).
- The pretence of knowledge and the fatal conceit: Heavy-handed options are generally based on socialist ideology or a belief that self-interested bureaucrats somehow know best. Or the proponent of the intervention mistakenly thinks that people are stupid.
- **IPI shuns heavy-handed approaches** and seeks market- and incentives-based solutions wherever possible. For instance, we are fundamentally opposed to the government being a businessman and would resist the thought that the government should own and manage a bus business – unless there is simply no other option. We always look for a way to regulate the market in the least intrusive manner – and even that only where a serious problem has been identified.
- Options analysis: Which of these options can yield a better outcome for society than the base case (free market)? To what extent do the options allow markets to determine supply, demand, and prices? - the more the market testing of a relevant price the better. If an option involves administered prices (e.g. for petrol or education) then IPI would look askance at the option. If prices are not market-determined, then by what objective mechanism will the government be able to assess actual demand and supply? We are reminded of the impossibility of economic calculation in a socialist economy that does not use market prices.
- If no option conclusively yields a far better option than free citizens (markets) acting voluntarily on their own accord, policy development should stop at this stage. The base case (Q1) is then the best option.
- Remember, the base case is always the first option on the table. If the base case is decided as the best option, go to Q.10.

#### 5. Strategic gaming test (sabotage by market players)

- Assuming we now have an option that seeks to give the government a role while not reducing freedoms unnecessarily, imagine a situation when such policy has been implemented.
- Put yourself in the shoes of the persons to whom the policy applies. Now:
  - imagine all possible ways by which people can game the system – i.e. how they can take advantage of any loopholes; and
  - identify the (unintended) consequences of such policy failures.
- Policy design is like a game of snakes and ladders. Each time we think we have solved a problem, someone with a sharper mind can unravel the plan and create problems that never existed before.
- A typical unintended consequence of bad policy is the moral decline of society, as people come up with new ways to cheat the government, e.g. through tax evasion or misuse of “free” government services. Distortions of work incentives are a typical aspect of strategic gaming.

Some private companies may try very hard to influence any market regulator, as part of their attempted regulatory capture. Pharma companies have basically destroyed the very concept of market regulation by capturing all regulators. Now we are getting the worst outcome – dictatorship by pharma companies, disguised as government-approved “science”.

- Given such considerations, how will a proposed policy deal with strategic gaming and unintended consequences?
- Badly designed policy can lead to **far worse** outcomes than the base case. Unless we are sure we have solved the strategic gaming test, we should revert the base case (Q.1).

## 6. Government failure test (sabotage by government functionaries)

- Public choice theory (and common experience) confirms that most bureaucrats perform their job indifferently and many will shirk work. (This is apart from any tendency for corruption.) 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. Their delivery of outputs is often very poor compared with their private sector counterparts, often at double the cost. The reason for this (known as government failure in the literature) is that *all* people are less diligent about spending other people’s money (in this case, taxes) than they are about spending their own money.
- Government servants who operate inside regulatory organisations are particularly vulnerable to be captured by industry, often through connections and incentives that are invisible to the rest of the world. Once captured, they undermine the parliamentarians’ intent of regulation.
- 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 the community, now describe how it will overcome the ever-present danger of government failure.
- In particular, what independent scrutiny of implementation of the proposed policy is included in the policy design? How will citizens get to know whether the policy is actually working or they are being deceived through fake reports about claimed outputs that do not exist and are delivered at inflated cost.
- And how will the proposed policy avoid regulatory capture?
- Unless we have very strong incentive mechanisms in place to prevent government failure, we should probably stick to the base case.

## 7. Real experience test (how has the proposed policy worked elsewhere)

- If you’ve reached this stage, the potential policy is probably quite good. But two more steps remain.
- 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 thoroughly.
- How will the proposed policy address these and similar gaps? There is never any “poor implementation”. There is only poor policy that failed to consider the implementation problem.

## 8. Cost benefit test

- Mathematical economic model: It is desirable at this stage to support the proposed policy with a detailed theoretical economic model that identifies its micro-economic logic. There will then exist a *prima facie* theoretical basis as well as practical evidence that the proposed policy is desirable and could work.

- CBA: A cost-benefit analysis: A utilitarian analysis (cost/benefit) can provide many useful insights after the analysis of liberty and other issues has provided justification for such policy.
- The final hurdle is to check whether the policy will actually provide a net benefit under a wide range of scenarios.
- In this step the social costs and benefits of the proposed policy are identified. Cite real evidence (not imaginary models or precautionary principle) to confirm that any asserted benefits are real, not imaginary. All assumptions must be documented clearly.
- It is crucial to also include environmental impacts, community impacts, family impacts and local government impacts.
- Where net benefits can be quantified, quantify them (detailed Net Present Value calculations are needed.)
- Once it is proven beyond reasonable doubt that social benefits will exceed costs even in the worst scenario, then proceed to get the policy implemented.

## 9. Freedom, property rights (and possibly ethics) test

This is where the deontological emphasis on liberty and property rights comes in. IPI requires a fundamental analysis of the loss of people's freedoms under various policy options. In addition (in a very few cases), claims about ethics could be considered under this test.

- 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.)
- Assuming a policy option is identified that yields a better outcome for society than the base case, does it reduce anyone's freedom? If so, whose? How? And why?
  - Note that taxation, being coercive (even if has been agreed through the legislature), amounts to a reduction in freedom. Likewise any attempt to subsidise something or someone. And just because we always do something in a particular way at present doesn't mean that is the best way of doing it, nor that it was the only way to do that thing in the past. We should thoroughly examine everything which reduces liberty and choice.
- The analysis of freedom and property rights impacts should be undertaken after a cost-benefit test is undertaken. Passing a utilitarian cost-benefit analysis does not necessarily make a policy valid. **A CBA test is necessary but not sufficient to support a policy.**
- In some cases, it is argued that an ethics test is suitable, and that could be conducted at this stage. However, it is crucially important to be aware that ethics has been used as a pretext or rationalisation for mass-scale crimes throughout history: let's not forget that Hitler considered himself to be a highly moral person. Therefore, any resort to ethics must generally not overturn the result of a CBA, but could supplement it by minimising harm.
- Examples:
  - During the covid pandemic, governments imposed policies that reduced the freedom of billions of people across the world and caused the death or shortening of life of millions from lockdowns. These policies harmed person X in the name of protecting person Y. Such policies will fail the freedom test even if they pass a cost-benefit test. Such policies will also fail standard ethical tests.
  - It is unacceptable to reduce freedoms for a large group of people to address harm caused by a few.

- It would in particular be wrong for the poor to suffer from a policy to benefit the rich. (This is typical of almost all socialist policies, such as town planning policies based on “beautification”, which push the poor to the margins of a city.)
- If a particular policy option reduces freedom or seizes property rights (reduces them), the broader gains to law-abiding citizens from reducing freedom must be overwhelmingly greater than the costs imposed on those who lose their freedom. This has to be conclusively proven.
- If the proposed option/intervention is unable to comprehensively and conclusively justify the restrictions it will impose on liberty, then it should be dropped and the base case (Q.1) reverted to. Or an alternative, less restrictive policy should be identified and the whole process of questions and testing started again.
- It is not good enough to use the **sunk cost fallacy** to continue with an option that passes a CBA but fails the freedom test. The policy work to reach this point is not relevant to a final decision. If the policy with a net positive benefit CBA offers a bad outcome for freedom, that policy is bad.

## 10. Transition path to the new policy

- In this last step, key transitional arrangements – that will allow the proposed policy to be implemented successfully should be outlined. In doing so, questions such as these can help:
  - 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? What are their views, how will they react?
  - Are there any obvious political constraints to implementation of the policy? (i.e. position of opposition parties?)
  - 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 (this might include losers, but also interest groups deliberately provided misinformation and falsehoods 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 the complete analysis appended for public consultation/ discussion.