

Somewhat Reasonable

The Policy and Commentary Blog of The Heartland Institute

Bill Niskanen, RIP

By Jim Johnston on Oct. 27, 2011

The economics profession has lost one of the giants. His best known work is a positive, as opposed to a normative, theory of bureaucracy. *Bureaucracy and Representative Government* was published in 1971.

The model of bureaucracy is based on a special form of monopoly where the government uses the rents to increase, rather than restrict, output. The government presents the consumer-taxpayer with an all-or-nothing decision. Under those conditions, as Milton Friedman has pointed out, consumers buy much more of a good or service than would be the case in a competitive market. Niskanen took this basic principle and applied it to government behavior, where the frequent cry is to eliminate waste and duplication.

Not only has waste been increased by government, but competition has been eliminated in many areas. In the private sector duplication, called competition, is encouraged. The result in government behavior, according to Niskanen, has been to double its size compared with a private sector provision of goods and services. His work was an inspiration to others who worked to explain government operations.

I first met Bill Niskanen in the early 1960s at the RAND Corporation. It was on the eve of the Kennedy Administration taking office when cost-effectiveness analysis, called the planning, programming and budgeting system, was brought to the Department of Defense in 1961 by Secretary Robert McNamara. RAND supplied many of the “whiz kids” during the 1960s, including Bill Niskanen. He was known as the Milton Friedman of the Defense Department and his colleague Alain Enthoven was known as the Paul Samuelson.

The program budgeting system alternatively configured the budgeting by resource (manpower, equipment, operations and maintenance, etc.) into weapon systems on which major decisions could be made consistently across traditional budget categories.

The theory of cost-effectiveness analysis of defense systems involves two principles. One is to maximize effectiveness for a given cost. The other is to minimize cost for a given level of effectiveness. A prominent example of the latter was the TFX, later renamed F-111, where that same airframe was ordered for both the Air Force and the Navy. The development cost savings were estimated in 1961 to be a billion dollars. The Navy version was later canceled in 1968 leaving the Air Force version saddled with the extra design features intended to satisfy the Navy. *C'est la guerre.*

Another contribution of cost-effectiveness analysis was to introduce discounting to the process. Niskanen was instrumental in introducing this alternative to the prevalent five-

year cost measure. Unfortunately the discount rate selected for many of the weapon systems was below the market rate in order to understate the cost.

After serving in the Pentagon, Niskanen went to the Institute for Defense Analyses as the head of the Program Analysis Division. It was there where he headed the project that compared the supersonic transport and the airbus. The airbus won. It was a rare occurrence when the solution from the analysis actually worked in the real world.

He later served as the chief economist of the Ford Motor Company. He resigned in principle over Ford's advocacy of restricting the imports of Japanese automobiles by the U.S. government. Again Niskanen was right. Ford later bought Mazda.

The biggest change in Niskanen's career came when he joined the Cato Institute as chairman in 1985. This surprised me very much. Both Niskanen and Cato's President Ed Crane had huge egos. I expected a fiery relationship that would soon explode. But I was wrong. Niskanen toned down his ego in all except policy issues and he stayed as Cato's chairman for 23 years. There is no evidence that Ed Crane's ego has been reduced. However, to his credit, Crane knows well how to get the most out of a group of strong personalities.

Bill Niskanen died of a stroke on October 26 while recovering from heart surgery. I lost a mentor and the world lost an economic giant.