

# Putting value creation back into ‘public value’: From market-fixing to market-shaping

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# Putting value creation back into ‘public value’: from market fixing to market shaping

Mariana Mazzucato and Josh Ryan-Collins

## Abstract

In conventional economics, the concept of value creation by the public sector is largely absent. Value is created in business with the state playing a reactive role in correcting ‘market failures’ to enhance economic efficiency. The term ‘public value’ has been adopted by scholars in public management and administration to attempt to go beyond this reactive role, focusing on how public-sector managers play an important democratic role in managing a trade-off between efficiency and the engagement of citizens in shaping policy. In this paper, we argue for a more ambitious and positive concept of public value which rejects the ‘market failure’ framework and puts public value at the centre of the economy, not in the periphery. Public value, we argue, is created by public sector actors creating and co-shaping markets in line with public purpose. This direction-setting role enables public, private and civil society sectors to collaborate effectively to solve societal problems.

**Keywords:** public value, social value; public policy; public choice; public administration; public management; efficiency; market failure; welfare economics.

**JEL codes:** A13; D46; D60; D63; D73; D78; H11; H21; H41 H44; H83; Z18

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# 1. Introduction

The attempt to justify and describe the distinctive value created by government and public-sector actors has a long intellectual pedigree. Terms such as 'public interest' and 'common-' or 'public good' have been a focus for political philosophers going back to Aristotle (Etzioni 2014). More recently, the concept of 'public value' has been developed by scholars in the public management and administration field (see, inter alia, Moore 1995; Stoker 2006; O'Flynn 2007). This concept of public value emphasises how public managers have an important role in mediating between the need for efficient services and the engagement of citizens in developing public services and policy.

This paper examines the intellectual origins of this notion of public value and argues that it relies too heavily on an intellectual framework derived from conventional economics where the role of the public sector is largely reactive, focused on correcting market failures to enhance economic efficiency. The concept of market failure emerged out of neoclassical welfare economics as an abstract theoretical concept rather than a framework for guiding policy. However, it has been interpreted and employed by policymakers as a justification for public policy intervention and in doing so relegated the role of the public sector to one of 'market fixing'. This tendency has limited the theoretical development of the concept of public value and perhaps helps explain why it has not become a more powerful policy framework outside the confines of public administration and the 'third way' politics of the early 2000s. We argue public value theory must go beyond the market failure policy narrative towards one that is founded on a collective understanding of value creation where markets are viewed as co-created by the public and private sectors, not only created by one and fixed by the other.

Our argument draws upon Karl Polanyi's (1957) insight that capitalist markets and indeed economic growth itself result from the interaction between different sectors of the economy, including the private sector, the public sector and civil society organisations. Thus, to separate out 'public' from 'market value' is misguided. Instead, public value should be understood as a way of measuring progress towards the achievement of broad and widely accepted societal goals (for example, a rapid but orderly transition to a low carbon economy). Such goals can only be achieved through collaboration between both private and public sectors which together, via the process of innovation, co-create and co-shape markets (Mazzucato 2016). As innovation and economic growth have not only a rate but also a direction (Mazzucato and Perez 2015), the role of the public sector in this market co-creation process is to create public value through providing public purpose. The notion of public purpose draws on Galbraith (1973), who warned against the dangers of public activity being captured by private purpose.

The paper is structured as follows. In section 2, we review the concept of market failure and public choice theory as the intellectual basis for the modern framing of debates around public value. Section 3 briefly discusses the emergence of New Public Management as the dominant paradigm in public policy itself and traces how the modern version of public value arose as a reaction to this in Anglo-Saxon democracies. Section 4 critically examines this modern version of public value. In section 5 we develop a broader notion of public value creation based on insights from the entrepreneurial state (Mazzucato 2013), the public commons (Ostrom 2005) and market shaping (Polanyi 1957; Mazzucato 2016).

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## 2. The economics of public value: fixing markets

Who creates value? The private sector is explicitly acknowledged as a value creator and the process of private firms creating value has been analysed extensively, most notably in economics, and business and management studies. There is no question that business can create value; the issue is more understanding how this occurs. In economics, the production function framework represents the microeconomic theory of value whereby businesses create value by combining capital (both tangible and intangible), labour and technology (Solow 1957; Romer 1989). In business studies, value is understood as being created inside the company by combining managerial expertise, strategic thinking and a dynamic division of labour between different workers (Bloom and Van Reenen 2007). In recent decades a 'resource'-based theory of the firm has extended this understanding to how dynamic capabilities are created (Teece et al. 1997). Key debates in this literature regard governance structures, for example the limits of shareholder value (Lazonick 2011; Kay 2012), and new ways to conceptualise value (Porter and Kramer 2002; Teece 1996).

What is the role of the public sector in the economic theory of value creation? In economics, public actors are recognised as having a role in terms of 'fixing' market failures (explored below) or 'enabling' value creation by investing in areas like skills, research and education, which are key, for example, to the development of technology and for a skilled workforce (the labour input). The state can also redistribute value through taxation. In macroeconomics, the theory of taxation is key to understanding redistribution of value. But there is no clear role for the public sector to create value itself. Hence the term public value does not exist in economics. Social value can be created through welfare analysis, tied to how a policy can make different actors 'better off' in terms of their utility calculations, but this fixing and redistributing function is not about creation itself. At best it is about redistribution or fixing problems along the way.

Market failure theory (MFT) provides a clear delineation of why and when the public sector can be active in an economy. It has its origins in neoclassical welfare economics and takes the first fundamental theorem (FFT) of welfare economics (Arrow 1951) as its starting point. The FFT states that markets are the most efficient allocators of resources under three specific conditions: (1) there is a complete set of markets, so that all supplied/demanded goods and services are traded at publicly known prices; (2) all consumers and producers behave competitively (that is, all agents are price-takers); and (3) an equilibrium exists. Under these three conditions, the allocation of resources by markets is Pareto-optimal (no other allocation will make a consumer or producer better off without making someone else worse off) and the state has no role at all in the value creation process.

Violations of any of the three assumptions lead to inefficient allocation of resources by markets – that is, market failures. If markets are not Pareto-efficient, then everyone could be made better off through public policies that correct the market failure. MFT suggests that governments intervene to 'fix' markets when the market fails due to positive externalities, negative externalities and information asymmetries. In the case of positive externalities created by 'public goods' (such as herd immunity or basic research), the state must produce what the private sector doesn't (vaccines and basic research), and in the case of negative externalities (like pollution) the state must devise market mechanisms to internalise external costs (e.g. carbon taxes).

A first point to note about MFT is that it was very much abstract theory rather than a formalised framework to guide public policy. Some eminent economists have rejected the market failure justification for policy intervention since the assumptions described above – perfect information, completeness, no transaction costs or frictions – have never been empirically demonstrated (Coase 1960; Stiglitz 2010). Rather, markets are always incomplete and imperfect, and hence not 'constrained Pareto-efficient', i.e. they are never in a situation where a government (a central planner) may not be able to improve upon a decentralised market outcome, even if that outcome is inefficient (Greenwald and Stiglitz 1986). And even if we accept the conditions, Pareto efficiency turns out to be practically useless in the real world of capitalist democracies as it implies that a single loser would have a veto over any policy.

This led to the development of a more utilitarian 'net welfare benefit'-type analysis to guide policy decisions, whereby instead of actual Pareto improvements, the test was that the net welfare benefits for the winners should be greater than the net costs for the losers (Hicks 1939). This was usually measured by estimates of gross national income in lieu of a better proxy for welfare. This approach then generates a justification for government redistribution via taxation and spending, with the winners compensating the losers. This is one of the main theoretical justifications for cost-benefit analysis (Tucker 2018).

Despite the concerns of some economists, the underlying intellectual framework of MFT began to gain policy traction in the 1960s and 1970s in advanced economies with the emergence of 'public choice theory', which attempted to apply neoclassical welfare economics to the study of political decision-making. Public choice theory considers how the actions of agents (voters, bureaucrats, politicians) involved in policy could be considered from an economic efficiency perspective, whereby those agents, including government agents, are assumed to be self-interested in the same way that private markets actors are assumed to be in neoclassical theory (Buchanan and Tullock 1962; Mueller 2004). While in markets the existence of competition and the profit motive tends to enforce efficient decision-making, in collective decision-making processes (i.e. politics and public administration) the same disciplining framework does not exist. Policymaking is thus considered to be subject to capture by certain interest groups, in particular those most able to influence policymakers due to reasons of power or money. This is particularly the case because rational voters have little reason to take an interest in political decisions since most voting decisions have only a very tiny impact on the voters' lives: the 'problem of collective action' (Olson 1965). In public administration, the lack of competitive pressures leads to 'bureau-maximising' behaviour, whereby departments and agencies look after their own survival rather than the 'common good'.

Given this, even where there are clear examples of market failure, it is not always the case that government intervention would result in a more efficient outcome. Rather, there could also be 'government failure', whereby decisions aimed at improving welfare make things even worse than they would have been under conditions of market failure (Le Grand 1991). With this approach, market failure is only a necessary but not sufficient condition for governmental intervention (Wolf 1989). The sufficiency results from an assessment that the gains from the intervention outweigh the associated costs due to 'governmental failures' (Tullock et al. 2002), such as capture by private interests (nepotism, cronyism, corruption, rent-seeking) (Krueger 1974), misallocation of resources (for example, 'picking losers') (Falck et al. 2011) or unfair and damaging competition with private initiatives ('crowding out') (Buiter 1977).

From this perspective, there is a trade-off between two inefficient outcomes, one generated by free markets (market failure) and the other by governmental intervention (government failure). The solutions advocated by some economists focus on correcting failures such as imperfect information (Stiglitz and Weiss 1981). Solutions advocated by public choice scholars (Buchanan 2003) focus on leaving resource allocation to markets (which may be able to correct their failures on their own) or the creation of market-type discipline within public agencies.

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### **3. Public value management: a response to New Public Management**

In business schools, mainly in the US, welfare economics and public choice theory influenced the development of 'New Public Management' (NPM), or 'new public administration' in the US case.<sup>1</sup> In essence, NPM argued that to address the risks of government failure described above, governments should adopt strategies from the private sector to maximise value in the public sector (Hood 1991; Osborne and Gaebler 1993). Key NPM concepts included the need to introduce some equivalent of the profit motive in the public sector to improve performance, e.g. efficiency targets; the related 'principal-agent problem' whereby there was an inability for the public (citizens) to hold public sector employees accountable in the way shareholders could hold a corporation's managers accountable (ameliorated by contracting out and/or privatisation of services); and the idea that the government should limit itself to technical efforts to counter various forms of 'market failure' (for a more detailed review, see Bozeman 2007, pp. 55-63). In doing so, this would minimise government failure and enhance public sector efficiency by introducing market discipline (Lane 2002).

NPM policies were widely implemented in advanced economies in the 1980s and 1990s, in particular in the UK, New Zealand and Australia (Hood 1995). By the mid-1990s, however, concerns were growing about the effectiveness of this policy regime. The term 'public value' first appeared in the public administration/public management context as a response to the perceived weaknesses of public choice theory and NPM in steering public policy. Scholars at Harvard University's Kennedy School of Government and Harvard Business School, notably Mark Moore (1995), working with public sector executives, developed a strategic framework for public sector managers as an alternative to NPM. Moore argued that a strategy for creating public value and for introducing new policies involves more than simply importing private sector practices and market discipline. Rather, it concerns the management of trade-offs between three domains: 1) the identification of the public value an organisation seeks to produce (which will be distinctive from that which the private sector produces); 2) the 'sources of legitimacy and support' that are relied upon to authorise the organisation to take action; and 3) the resources necessary to sustain the effort to create that value. In contrast to private sector strategies, strategic management in the public sector has a longer-term

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<sup>1</sup> New Public Management was also influenced by other intellectual frameworks, in particular the spread of scientific 'managerialism' and manifested in different fashions in different countries (see Hood 1991 and Gruening 2001 for discussions).

focus, attends to larger issues with significant impacts on performance rather than incremental issues that affect productivity, and concentrates on ends rather than means (Moore 1995, pp. 162-184).

Particular emphasis is placed on the role of the public manager in managing policy development and negotiating (public) purpose with politicians, leading public deliberation and 'social learning'. The political and philosophical aspects of public performance management are at least as important as the technical aspect. To produce value, public officials must consider the entire 'value chain', which starts with inputs and moves to the production processes (e.g. policies, programmes, activities) used to transform the inputs into outputs, which then affect a client (e.g. citizen, beneficiary etc.), which leads to the social outcome that was the intended aim of the activity. In contrast, NPM approaches usually focus on just one part of the value chain; for example, traditional line item budgeting is focused almost exclusively on 'inputs' (e.g. staff costs).

Moore (2014) attempts to develop a grounded philosophical basis for the concept of public value, that asserts a key role for defining its value as lying in the hands of the public '...organised through the "quite imperfect" processes of democratic governance' (p. 473). This makes the evaluation of public value challenging as citizens typically have different general concepts of justice and fairness, which may change over time and from issue to issue. Public value accounting schemes thus need to be dynamic and allow for change in citizens' views of the important dimensions of public value.

Moore (2013) also develops the concept of a 'public value account' as a means of keeping track of how the strategy of a public-sector organisation develops and its impact on others. This approach emphasises intended and unintended negative and positive consequences from public policies as well as equity considerations and the idea of 'mission achievement' – all of which would typically be missing from the NPM approach. The basic argument is that rather than searching for a universal way of evaluating public value, each social problem that society confronts 'requires an approach that engages public deliberation about what particular value they are trying to produce and the creation of a particular accounting scheme that express those values' (Moore 2014, p. 473).

Moore's understanding of public value proved to be especially influential in English-speaking countries, mainly because this is where NPM influence was also strongest (Stoker 2006). In the UK, the New Labour government, informed by Tony Blair and Bill Clinton's 'Third Way', began to develop the idea of public value as a yardstick for measuring policies and institutions' effectiveness. Kelly et al (2002), who were advising Blair's government, argued that public value should be concerned with outcomes (rather than outputs), including equity, ethos and accountability; the means used to deliver these outcomes; and with the generation of trust and legitimacy in government. Public value is not created by governments through the provision of services, laws and regulations, but '...determined by citizens' preferences, expressed through a variety of means and refracted through the decisions of elected politicians' (Kelly et al. 2002, p. 6). Following Moore, they preferred an evidence-based approach to definitions of value that was able to change over time and be shaped by policy experience of what actually worked in reality. This approach to public value contrasted with NPM by putting the public itself, via democratic influence and public deliberation, at the heart of the concept.

In a similar vein, Stoker (2003) argued that 'public value management' (PVM) provides a framework for managing the trade-off between efficiency and democracy that is at the heart of public management. Stoker stressed an expansion of the scope of the 'political' as central to the PVM

approach, with politics the means by which diverse opinions can be incorporated in a version of the common good. In this approach, governance of the public realm involves 'networks of deliberation and delivery in the pursuit of public value because people are fundamentally motivated by the kinds of partnerships they work in which depend on mutual respect and shared learning' (Stoker 2006, p. 56).

One acknowledged challenge for this approach is the possible time-lag between the emergence of a problem and the public formation of preferences about the solutions to that problem to help guide policy. This gives rise to a more general concern about how established preferences must also be informed. This is where political leaders have a role in shaping as well as accommodating public preferences (Kelly et al. 2002, p. 7). There is much value in 'a leader who creates new preferences and fulfils them, as opposed to simply addressing the preferences that already prevail' (ibid).

Preferences can also be incorporated into policy by more actively involving citizens and service users in the design and delivery of services. To enable this, public providers must become more visibly responsive and more participatory than merely consultative. There is a need for more direct, innovative and creative opportunities for users to participate in the 'script' of public services (Leadbeater 2004). Users need to receive services according to their needs, but also to play a role as 'co-designers' and 'co-producers' in the shaping and delivery of that service.

This notion of 'co-production' (Ostrom 1996) became popular in academic and think tank circles in the UK in the mid to late 2000s (Bovaird 2007; Stephens et al. 2008). To enable co-production, an 'adaptive state' would be required with public sector organisations needing to develop the capacity to learn for themselves and 'factor in aspects of the authorisation environment that ensure responsiveness to changing public needs' (Bentley and Wilsdon 2003). User-shaped and personalised services are, therefore, valuable sources of public value.

Particular experiments on building public value through new forms of engagement between the state and citizens have been informed by this approach. The work by the Government Digital Service (GDS) team in the UK Cabinet Office made it a point to reject the idea from New Public Management of citizens as 'customers' and 'clients', focusing instead on the role of citizens as users. This involved completely redesigning GDS, and its main product, gov.uk, to be focused on user needs and user design (Greenway et al. 2018).

One interesting concrete example of how public value has been employed to support the legitimacy of a publicly-funded activity is the British Broadcasting Corporation (BBC). The BBC used the concept extensively in its two most recent Charter Renewal documents. In its 2004 renewal document, it presented a conception of public value based on the three principles on which it was founded: universality, fairness and accountability (BBC 2004). The BBC's appeal to public value is a clear attempt to clarify its mission in the face of considerable pressure from commercial broadcast media. Public value is used to justify the receipt of public funds and to give practical guidance to all levels of public management on the delivery of publicly-valued broadcasting. The BBC's own research and large-scale survey conducted by Ofcom in 2004 suggested that the public continues to define public service broadcasting as a broad and integrated system of programmes and services. It is thus both a clarification of public conceptions and a popular appeal to claim that the BBC exists to create public value. Certainly, it aims to serve its audiences not just as customers, but also as citizens in a democratic society (Blaug et al. 2006, p. 26).

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## 4. Limitation of public value management theories

This review of the literature of public value has shown how neoclassical public choice and welfare economics approaches have come to shape academic and policy discussions of the topic. Broadly speaking, the public management literature in particular has reacted to the dominance of New Public Management regimes not by challenging the fundamental assumptions lying behind notions such as market failure, but by attempting to develop frameworks that substitute the 'consumer' for the 'citizen' and thus bring politics/democracy back into the process of public sector decision-making. With this approach, public value is basically conceptualised as a 'third way' of justifying the existence of public services and public managers beyond traditional Weberian-type top-down bureaucratic management and new public service management regimes (Pollitt and Bouckaert 2004). Public value is theorised as a means of reconciling the tension between democracy and bureaucracy, the basic idea being that public servants must be accountable both to politicians and also to the wider public/consumers of services – the 'authorisation environment' (Moore 1995).

The implication of this approach in regard to measurement is that the public itself must be an active participant in the measurement of public value. Much of the literature is focused on how best to do this, e.g. opinion polls, stakeholder workshops, 'consensus conferences', citizens' juries. Relatedly, economists have attempted to 'monetise' public value via techniques such as contingent valuation (see Cowling 2006 for a review). But there is little consensus on which of these forms of engagement is most accurate or useful. There is also concern that the public tends to hold contradictory views on certain issues at the same time, that views can change over time and that there is a danger that such an approach actually undermines standard democratic processes and power imbalances (Feldman and Khademian 2002; Rhodes and Wanna 2007). Measurement is also complicated by the fact that public value creation tends to occur at the end of the value 'chain', e.g. when people's lives improve (outcome rather than output), potentially many years after the policy was enacted. This contrasts to the private sector where the value can be seen to be created upstream at the point of purchase of a product.

A number of critiques of public value as applied to public management (henceforth PVM) and public service reform have emerged. A common critique is that it is excessively vague (Oakley et al. 2006; Rhodes and Wanna 2007; Sekera 2016). Various different proponents have argued it should be seen as a 'paradigm', a 'model', a 'heuristic device', a 'story', and that 'perhaps the ambiguous nature of public value and its various applications fuels its popularity – it is all things to all people.' (Rhodes and Wanna 2007, p. 408). Sceptics of New Labour argued that it had little meaning and was opportunistically employed to justify ongoing public service reform that didn't seem to be achieving results (Crabtree 2004). Similarly, the BBC was fiercely attacked for its aforementioned Building Public Value document (2004), which was seen as a means of obscuring the real debate about the pros and cons of public service broadcasting in an age of multi-spectrum broadcasting. The central focus on individual consumer opinion central to public value grated awkwardly with the BBC's emphasis on pedagogic, civic and informing (public) purposes (Oakley et al. 2006). We develop this argument further in the next section.

PVM has also been critiqued for allowing and encouraging public managers to stray into the political domain, increasing their bureaucratic power in pursuit of their mandate in the name of 'civic discovery' (Roberts 1995, p. 293). A large body of research in public services motivations suggests public service managers have other motivations than a pure public service ethos (Perry and Wise 1990). Going a step further, some scholars have argued that PVM can be seen as a political project which attempts to legitimise neo-liberal theory and market rationality, and downgrade democracy. Implicit in the theory, it is argued, is the idea that public managers are being asked to 'rebel against standard politics and usurp the democratic will of governments' (Rhodes and Wanna 2007, p. 413). The result of this may be that the citizen participation process becomes a means of enhancing the legitimacy of public managers rather than a truly democratic process (Dahl and Soss 2014). According to this critique, PVM avoids foundational political economy questions of power and conflict and 'substitutes "managed democracy" for more democratic forms of rule based on shared power' (ibid, p497).

A further limit with PVM is that it restricts its domain to that of public services and public sector management rather than the more ambitious goal of a broad framework for public policy, including, for example, science and innovation policy. Barry Bozeman (2007) developed a conception of what he calls 'public values' (emphasis added) as part of an effort to operationalise the broader concept of the 'public interest' that incorporates both private and public activity. He argues that 'public values' are those:

*"providing normative consensus about (a) the rights, benefits, and prerogatives to which citizens should (and should not) be entitled; (b) the obligations of citizens to society, the state, and one another; and (c) the principles on which governments and policies should be based"* (Bozeman 2007, p. 132)

Bozeman contrasts public values with the 'public interest' which 'refers to the outcomes best serving the long-run survival and wellbeing of a social collective construed as a "public"' (ibid, p12). The concept of public interest closely follows Dewey's notion of pragmatic idealism whereby one keeps 'in mind an ideal of the public interest, but without specific content, and then moving toward that ideal, making the ideal more concrete as one moves toward it' (p13). Whereas the public interest is an ideal to be pursued, but not tied to any specific content, public values have content and, in many cases, can be easily identified, measured and evaluated.

Public values can also be distinguished from public goods, because they are not dependent on pricing efficiency for their identification. The key question for public goods is: 'Is it possible to exclude those who do not pay for the good?' whereas the key question in public values is: 'Have those public values endorsed by the social collective been provided or guaranteed?' (Bozeman 2007, p. 15).

Bozeman's public values approach has an advantage over the Moore-inspired conception of public value in that it offers a potentially broader framework to guide public policy. In essence, the public values approach is a call for efficiency – considered through a market-failure lens – not to dominate discussion of public policy just 'by force of available analytical tools' (ibid, p. 158). Efficiency is just one amongst many 'public values' that could be held at any time by the public. However, Bozeman's concept of public value remains largely a negative conception, whereby the justification for public policy arises because of a market and public failure. In this sense, it is still perhaps somewhat

constrained by the flawed market failure theory framework and a juxtaposition between public and private value.

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## 5. Towards a theory of collective public value creation

A more positive theory of public value requires beginning with a notion of the public good not as a correction to a failure, but as an objective in itself; an objective that can only come about if linked to a process through which value is created. In this sense it needs a new building block for guiding and legitimising public policy. As indicated by Kenneth Arrow (1962), while a market failure approach can be utilised to understand why, for example, private firms underinvest in R&D, it is not so useful in guiding public investment in R&D, because of the inherent uncertainty involved in the outcomes from such investment. Indeed, Arrow called for alternative approaches to analysing public investment and policies for innovation.

Critically, the market failure justification implies that pure private markets/private goods can exist independently of public or collective action. While the role of institutions are admitted (North 1991), the role of different voices coming together to form the notion of the public itself is left mainly to sociology, not economics. Nelson (1987) notes that, 'There is no satisfactory normative theory regarding the appropriate roles of government in a mixed economy' (p. 556) and no theory that captures the complex variety of institutional arrangements that people have developed to solve collective problems. Just as pure public goods are rare, so too are pure private goods. Babysitters or sharing everyday appliances such as lawnmowers involves no government intervention or regulations, but does involve collective or 'public' negotiation. Hence the 'market failure' dichotomy is not particularly useful.

We can return to our example of the BBC to illustrate this argument. In a traditional market-fixing view, public organisations should limit themselves to investing in those areas that the private sector does not invest in, for example due to the public good nature of the product. Yet successful public organisations, like the BBC, are often successful precisely because they do not see their role as correcting a problem (the public good problem), but rather see creating public spaces, goods or services as an objective in itself. This means having an internal discussion about public value that goes beyond specific areas where it is 'permissible' to invest in, but rather focuses on process. In the case of the BBC, as described in section 3, it is deemed acceptable for it to invest in areas like documentaries, high quality news and televised theatre – but less acceptable for it to invest in areas like soap operas and talk shows as the latter are seen to be commercial. And yet it is precisely due to the internal discussion about public value as a process of creating content that it achieves citizen engagement and learning, that it goes beyond the usual areas for a public broadcaster. It also created soap operas like *EastEnders* about the lives of the working class (rather than *Dallas* and *Dynasty*-type soap operas on the lives of the rich and famous) and talk shows that sought to engage the public with sensitive areas like racism, feminism and classism. The criticism that the BBC is 'crowding out' private broadcasters comes from the static notion of the market – as though parts were for business and parts for the public sector, with little emphasis on process (Mazzucato and O'Donovan 2016). Indeed, the absence of a proper theory of public value – in economics – is clearly

exhibited when the BBC interacts with the Treasury, a topic we return to below when we look at evaluation.

## Markets as outcomes

We propose an alternative approach, which begins with the notion of public value as collectively generated by a range of stakeholders including the market, the state and civil society. Key here is the emphasis on value creation at the core: not 'public' value but value itself – with a clear delineation of the role of the different actors that are central to its formation. While in economics value is, in essence, created inside businesses and only facilitated by the public sector, in this view value is co-created and requires a stakeholder understanding of capitalism itself (Hall and Soskice 2001).

This view draws on the work of economist Elinor Ostrom (2005) who described the very complex structures and relationships of various types of institutions. She shows that a radical state-private division is, to use her word, barren. In developed economies there are many types of organisations. Non-partisan government regulators, state-funded universities and state-run research projects, for example, are quite different. Besides, the crude binary state-private division fails to capture the many ways in which all institutions create and destroy value. In addition, Ostrom's (1990) emphasis on common-pooled resources and her interest in shaping systems, so that they take in to account collective behaviour, can help shape new policy tools.

This more collective view also benefits from a different understanding of the market itself, with the market as an outcome of the interactions of individuals, firms and the state, as discussed in the work of Karl Polanyi (1957; 1957), and 'embedded economies', as discussed by Granovetter (1985). Polanyi argues that capitalist market societies are constituted by two opposing movements – the laissez-faire movement to expand the scope of the market, and the protective countermovement that emerges to resist the disembedding of the economy that the so-called 'self-regulating market' entails. As Polanyi (1957:146) noted, 'The road to free markets was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism... Administrators had to be constantly on the watch to ensure the free working of the system'.

All groups in society have participated in this project, including capitalists themselves, who throughout history have acted to effectively 'save capitalism from itself' (ibid: 45-70). In this sense, the work of trade unions in fighting for an eight-hour working day and workers' rights (even those benefitting non-unionised workers) are fundamental to market creation.

If value is created collectively a first question becomes what capabilities, resources and capacities are needed for this value to be created inside all the different organisations, including those in the public sector, private sector and civil society? In the same way that a theory of private value creation benefits from a resource-based theory of the firm (Penrose 1959), so does a public value notion. Indeed, it is by sidelining the notion of value as only created in business and facilitated or redistributed by the public sector that the question of capabilities is missed. The work by Teece (1990) on the dynamic capabilities of the firm becomes equally necessary for the public sector, as argued by Kattel and Mazzucato (2018).

A collective theory of value creation requires understanding investment and production capacity in all actors. Indeed, as discussed by Mazzucato and Sekera (2019), a theory of public value needs to also understand the productive capacity and capabilities of the state. And if the state loses that capacity it

will lose, its “absorptive capacity”—hence be unable to understand technological and market opportunities (Cohen and Levinthal, 1990). Public goods should not be seen as simple corrections to the (market failure) problem of positive externalities, but as objectives in and of themselves. This require imagination, investment and capabilities.

Similarly, instruments like taxation are no longer about correcting externalities, but about creation itself. Adam Smith’s notion of the free market was free from rent and this distinction between rent and profits requires tools to incentivise creation not extraction of value (Mazzucato 2018a). Thinkers such as Ricardo, Mill and even Adam Smith recognised that unfettered markets were often inefficient, prone to capture by special interests and could have negative distributional outcomes without ongoing intervention by the state. In particular, there was a recognition between productive profits and economic rents that represented unearned income deriving from arbitrary control over resources. These authors argued that the primary role of taxation, for example, rather than internalising externalities caused by identified ‘market failures’, should be to tax away rents accruing from the monopolistic ownership of factors of production, in particular land (Mazzucato 2017, pp. 39-45; Ryan-Collins et al. 2017, pp. 37-64). In the classical view, rents did not accrue from market ‘imperfections’ as in market failure theory, but from the inherent imbalances in economic and political power that characterised dynamic capitalist economies.

Indeed, the modern UK land market is a good example of how a lack of state direction setting and ‘market shaping’ towards public purpose can lead to rent extraction and reduced public value. Rather than focusing on a goal of, say, affordable, high quality and secure housing for all, irrelevant of tenure, successive British governments have assumed that it is possible to create an efficient market in housing that can ultimately provide everyone with a privately-owned home. Rather than subsidising the supply of decent housing (including, for example, rental accommodation and publicly built social housing) and land, as was the case in the 1950s and 1960s, governments have instead attempted to correct a perceived market failure in the cost of housing by subsidising the demand for private homes via mortgage subsidies and loans to first-time buyers. The assumption, presumably, was that more homes would be provided if the pent-up demand was released via additional finance. Instead, because of the inherently limited supply of land in desirable locations and developers being reluctant to build out rapidly through fear of reducing house prices, the result has been even higher house prices (Ryan-Collins 2018). This has eventually resulted in an affordability crisis and increasingly uneven distribution of wealth between generations.

Thus the focus is on the economic and political processes, institutions and conditions that enable public value creation – and equally on how to counter public value extraction – across sectors and economies (Mazzucato 2018a). The role of the state is key here, since it is the only institution with the power to shape markets and direct economic activity in socially desirable directions – or ‘missions’ – to achieve publicly accepted outcomes (Mazzucato 2013; 2016). Similarly, many government interventions enable markets to function, such as legal codes, public policies, antitrust policies, university scientists and physical infrastructure (Nelson 1987, p. 550). In many cases, government ‘is better regarded as a useful actor in its own right, and even as a precondition for other institutions to work decently, than as an actor reluctantly involved because they do not’ (ibid, p. 556).

Evolutionary and institutional economists and economic sociologists have paid particularly close attention to the interaction between the state and commercial actors in the generation of innovation

and economic growth. Markets are always institutional constructs and this requires asking not why markets fail, but rather what conditions are required for 'getting the work done'. (Nelson 2017). In particular, in the area of technological development, governments have played a key role in promoting innovation (Mazzucato 2013; 2016). The broad and deep presence of public organisations across the entire innovation chain requires understanding the more active role that public organisations play in providing patient, long-term finance (being 'investor of first resort') and in areas of high risk/uncertainty, with the risk-averse private sector entering only later. A simple analysis through the existence of positive or negative externalities is not enough to understand this entrepreneurial role – a role that, for example, was essential for all the technologies that are in our smart products (Internet, GPS, mobile phones, etc.) (Mazzucato 2013).

Public value in this conception is broader than the version developed in the public administration literature, which largely confines itself to the delivery of public services – or a legitimisation of the role of the public servant – rather than the role of government in shaping effective markets and the wider public outcomes that are broadly recognised as desirable (for example, ecological sustainability, a more even distribution of wealth and income, high-quality care for the elderly and fulfilling work).

Here the state is viewed as having a potentially important macroeconomic role, going beyond a simple Keynesian counter-cyclical role, with a stronger directional push. Indeed, many of the technologies listed above came from 'mission-oriented' investments where the state laid down the path – to go to the Moon or in modern days to fight climate change (Mazzucato 2018b, c). Missions require different actors to come together, so while the state can play the role of setting a direction, the bottom-up solutions that follow create an economic multiplier from cross-sector investments. Public value should thus be as much concerned with the direction of growth (and the macroeconomic implications) as with the microeconomic structure of government agencies. The question should be how to shape and co-create markets, not just how to correct them. Here, of course, there are many lessons that can be learned from the contributions from public administration theory described earlier. In particular, the concept of citizen involvement and co-production could, for example, be central to how to think about the co-creation of mission-setting (Mazzucato 2018; Kattel et al. 2018).

If the public part of value creation is guided by different criteria from the private sector, it must also be evaluated differently. Rather than checking which market failure has been corrected, the question is what form of new market has been created? For this to occur it is necessary to have a view of the public sector doing more than fixing markets.

## A new framework

This notion of collective value creates a new agenda to reinvigorate a theory of public value that can address the production of goods and services in the economy (including public services), where the public part of that production engages in questions that involve both the economic sphere as well as the organisational sphere. The focus is on how public organisations interact with other actors – with a focus on the need to collaborate and interact widely across the economy.

By focusing on collective value creation, it is useful to observe the interactions between different actors over specific landscapes (the health sector, the creation of liveable cities, the digital economy),

bringing back the 'objective' focus of classical political economy, but with a special eye on dynamic interactions. For this purpose, a mission-based approach where direction setting is followed by cross-actor, cross-sector and cross-disciplinary interactions provides a useful way forward (Kattel and Mazzucato 2018; Mazzucato 2018b, c).

If public value is to truly serve the public, finding new interactive ways to engage with the public is key. Instead of seeking consensus, it should be acknowledged that public value is inherently contested in the political arena where 'differing interests are resolved and conflict and argument lead to decision and action' (Stewart and Ranson 1988). Finding ways for public policy to interact in genuine ways with citizens and social movements will be key part of any society's ability to collectively create value (Leadbeater, 2018).

Importantly, new evaluation indicators are needed to capture the economy-wide benefits of such policies, including the (un/intended) dynamic spillovers and the 'additionality' – making things happen that would not have otherwise occurred. For this purpose, it is essential to move beyond cost-benefit analysis and allocative efficiency approaches to embrace a more dynamic notion of efficiency (see Kattel et al 2018 for an elaboration). Table 1 captures key differences in evaluating a market-shaping process.

The identification of different actors and their interactions also requires attention to be given to how the benefits are distributed. A theory of public value thus needs to look at both the creation of value and how it is shared. For this purpose, it is useful to consider the building of mutualistic eco-systems of true partnership (e.g. with no free-riding) and also a focus on creation rather than extraction – the latter being represented by 'rents' in classical economics.

Table 1: Approaches to public value: correcting failure vs. creating value (adapted from Kattel et al. 2018)

	Correcting failures	Creating value
Justification for the role of government	Market or coordination failures: <ul style="list-style-type: none"> <li>Public goods</li> <li>Negative externalities</li> <li>Imperfect competition/information</li> <li>'Public value failure' (Bozeman)</li> </ul>	All markets and institutions are co-created by public, private and third sectors. Role of government is to ensure markets support public purpose, also by involving users in co-creation of policy
Business case approach	Ex-ante cost-benefit analysis employing allocative efficiency, i.e. assuming all else remains equal (prices/relationships etc.) and incorporating possibility of government failure.	Focused on systemic change to achieve mission – dynamic efficiency (including innovation, spillover effects and systemic change)
Underlying assumptions	Possible to estimate reliable future value using discounting and backward-looking datasets. System is characterised by equilibrium behaviour	Future is uncertain because of potential for novelty and structural change; system is characterised by complex behaviour, non-linear feedback loops
Evaluation	Focus on whether specific policy solves market failure and whether government failure avoided (Pareto-efficient).	Ongoing and reflexive evaluation of whether system is moving in direction of mission via achievement of intermediate milestones and user engagement. Focus on portfolio of policies and interventions, and their interaction
Approach to risk	Highly risk averse; optimism bias assumed	Failure is accepted and encouraged as a learning device

## 6. Conclusion

In this paper we have argued for a rethink of the concept of public value that broadens its application beyond the public management and administration sphere. To do so we argue it is necessary to reject the 'market failure' framing under which public value scholars and policymakers have developed the concept. Rather than seeing public value as something that occurs when the public sector corrects market failures or successfully mediates the trade-off between democracy and efficiency, we argue public value creation must involve the public sector setting a direction and public purpose for private and public actors to collaborate and innovate to solve societal problems. This is a 'market-shaping' and 'market-creating' role rather than a 'market-fixing' role, and is inherently positive rather than negative in framing. It also requires an ontological shift – rather than markets being seen as abstract phenomena that 'work by themselves', they are better understood as outcomes of the interactions between public and private actors, following Karl Polanyi.

This is not to say that the existing literature on public value does not have its strengths, in particular the focus on citizen engagement and co-production. For direction setting and market shaping to be democratically legitimate requires bottom-up pressure and distributed experimentation to

complement and steer ambitious leadership. But it's clear that the immense challenges of modern-day capitalism can only be confronted through different actors coming together to co-create value by each investing time, energy and imagination on how to solve problems.

Going forward, to further develop this concept of public value creation will require research on how public value can be nurtured and evaluated. Indeed, it is precisely because the public sector is not seen as creating value, but only facilitating or redistributing it, that the dynamic capabilities to create value have not been created (Kattel and Mazzucato 2018). The curriculum for Masters in Public Administration (MPA) continues to be framed by public choice theory, which starkly warns public actors not to 'crowd out' private ones or get captured along the way, all leading to a diminishing of ambition and vision inside public institutions in their ability to transform landscapes, not only to fix them. Yet to create value, it is essential to develop the capabilities to explore and experiment, and to learn by trial and error. A new dynamic curriculum for civil servants is needed to engage with citizens in creating purpose-driven policies and organisations; risk taking and portfolio management for investment strategies; and new tools for evaluation.<sup>2</sup>

On evaluation, theoretical and practical approaches to policy evaluation should be enriched and diversified in order to create the capacities needed to deliver direction-setting policies. Governments should embrace new tools and techniques from service design research that focus on user experience and co-creation practices, and from evolutionary economics and related disciplines that focus on shifting and shaping technology and innovation frontiers, and managing complex systems in contexts of uncertainty.

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<sup>2</sup> The UCL Institute for Innovation and Public Purpose (IIPP) begins a new MPA on Innovation and Public Value in September 2019. It is also hosting a Mission-Oriented Innovation Network (MOIN), co-funded by the Rockefeller Foundation, which aims to find new tools for public organisations to set purpose-objectives, and welcomes the experimentation process that this entails, including with new types of partnerships. For information <https://www.ucl.ac.uk/bartlett/public-purpose/partnerships/mission-oriented-innovation-network-moin>

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