Chapter 2
The Institutional Economics of Stakeholder Consultation; How Experts Can Contribute to Reduce the Costs of Reaching Compromise Agreements

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Abstract Complicated projects, policy plans and government regulation usually involve a number of stakeholders with diverging interests. A good infrastructure for the consultation of, and for the discussion between these stakeholders is needed in order to avoid high implementation costs. Following the theory of new institutional economics these implementation costs can be seen as transaction costs. This is especially relevant in Government-to-Business (G2B) and Government-to-Consumers (G2C) relationships where the projects and policy measures bring about (re)distribution problems. This chapter discusses various ways to organize these consultations with the help of experts as intermediaries, so that a compromise agreement is reached on the solution of the (re)distribution problem. These institutionalized structures of consultation are referred to as "matching zones". Practical experiences, mainly from the Netherlands, provide guidelines for the effective institutional setup of such "matching zones". Specifically, the design of a "matching zone" should try to adhere to the following principles: *(i)* there should be a common interest and ample incentives for reaching an agreement; *(ii)* there should be the prospect of long, repeated interaction; *(iii)* there should be a balance between representation and efficiency; *(iv)* the constraints should be clear from the onset of the matching zone; *(v)* fairness should be strived for; *(vi)* IC technology should be utilized optimally; and *(viii)* informal contacts and an amicable atmosphere should be promoted. Most importantly, however, independent experts appear to fulfil an important role in order to reach compromise agreements at sufficiently low implementation costs.

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2.1 Introduction

In modern economies, with full use of information and communication technology, the execution of projects and implementation of policy plans are becoming more and more complicated. Various stakeholders are involved. They want their interests to be safeguarded. So, clashes between the government, private parties (business or citizens) in these Government-to-Business (G2B) and Government-to-Citizen (G2C) relationships are ever more likely. For instance, infrastructural and building projects are increasingly prone to "NIMBY"[1] objections, thus increasing the need for *ex ante* discussion. In the meanwhile, regulatory pressure and government inefficacy continue to be major impediments to efficient business and the functioning of government services. It may lead to long and costly delays in the preparatory stage of large projects, and in high implementation costs of policy plans, and legal regulatory measures. In the Netherlands – a tightly-packed country with high levels of business activity and a strong regulatory government – this potential for large costs, which in a general sense can all be regarded as transaction costs, is even greater than usual. As such, there is ample opportunity for an improvement of the way in which interaction between the government and society is designed.

That is why, in the Netherlands, some practical experience has been obtained in the setup of an infrastructure for the strategic and policy discussions between relevant stakeholders in these projects, plans and regulatory measures. Part of it goes back to the (in)famous "polder model" where great efforts have always been made to reach consensus, or at least compromise agreements between stakeholders with different interests in matters of (re)distribution of welfare. Out of these experiences an institutional innovation has risen in the Netherlands, which has been labelled "matching zone". In a matching zone, the government organizes an institutionalized forum for decision-making between the government and society – the latter consisting of businesses and/or citizens. This forum is often mediated by experts with a broad overview of the policy situation, who can depoliticize the debate, and point out creative and effective solutions. The objective of this institutional innovation is to lower the transaction costs while optimizing policy outcomes.

Matching zones have proven their worth in both theory and practice. In practice, several matching-zone-type institutions have shown to demonstrate better outcomes than the *status quo ante* – often a setting in which the government decides on policy and subsequently runs into trouble implementing it because of societal obstruction. Regulatory pressure can be relieved, while the government itself may also avoid duplicating work. Moreover, transaction costs in establishing rules and/or regulatory measures and implementation are lowered. This has come about through carefully crafted organizational mechanisms, but also through institutional experimentation. Theoretically, matching zones also provide for the resolution of collective action problems between, for example, firms and citizens, or firms and

[1] Not In My Back Yard.

firms. Through repeated interaction, mutual trust and an incentive to cooperate are cultivated, so that parties spend more time on achieving efficient outcomes and less time on factional bickering and "trench warfare". Employing neutral experts in such situations of potential conflict is often essential for participants to put their trust in such institutions.

This chapter seeks to link the practical experiences of matching zones with the theory of new institutional economics (see e.g. Ménard and Shirley 2005). Although it is not yet possible to make a systematic evaluation of the transaction cost reduction that matching zones bring about, some broad lessons can be drawn from both practical and theoretical insights. Through a proper design and management of matching zones a fall in transaction costs and an improvement in policy outcomes can be obtained. In that case the design and management of the matching zone should adhere to a number of principles, as discussed in Sect. 2.5 of this chapter. Although the experiences described in this chapter mainly stem from the Netherlands, these principles have a general validity, and can be applied to a broad range consultation and compromise finding activities involving different representatives of stakeholders.

In line with the theme of this book, the chapter pays ample attention to the role of experts as intermediaries in the negotiations between stakeholders. It is essential for these experts to be independent and have no specific stakes in order to facilitate reaching compromise agreements at sufficiently low implementation costs. In that sense the chapter is not so much on reaching consensus but rather on reaching compromise with the help of experts. However, in order to come to a compromise agreement at lowest implementation costs, it is a prerequisite that there be consensus amongst the stakeholders that the compromise is the best possible one. In some of the cases discussed in this chapter it is therefore required that in the negotiation process unanimity on the compromise agreement is to be reached.

The contents of the remainder of this chapter are as follows. Section 2.2 discusses the meaning and significance of matching zones, it elaborates which different types of matching zones can be distinguished and explains the demand for matching zones. Section 2.3 then describes four cases in which matching-zone-type institutions were employed. Three cases stem from the Netherlands and one from Brazil. Given these practical examples, Sect. 2.4 investigates how the setup of consultation in matching zones can be embedded in, and be based upon modern theories of new institutional and transaction cost economics. Section 2.5 distils lessons at the strategic, tactical, and operational level for future matching zones from the preceding discussion. Section 2.6 concludes.

2.2 Matching Zones

2.2.1 Definition and Types

The term "matching zone" as a label for the institutional setup of consultation and compromise finding between representatives of stakeholders asks for a precise definition and a comparison with other similar concepts. Moreover, it is useful to make a number of analytical distinctions between different types of matching zones.

The aim of a matching zone is to provide an institutionalized infrastructure for the interplay between either representatives of businesses and the government or citizens and the government in order to reduce the implementation or transaction costs of projects and government intervention. A matching zone can therefore be defined as an institutionalized structure of consultation, in which the government interacts on a policy legislation development level with sectorial representatives of businesses. It is important that the matching zone brings together the relevant political and economic agents, in order to provide for an "arena" in which discussions and negotiations between different interests can be conducted in a cooperative way. A first prerequisite for a matching zone to be effective is that *only* relevant, but also *all* relevant stakeholders take part in the discussions.

There are a number of adjacent concepts. One of these is the notion of the "orchestration of chains" (Den Butter 2012; Van Veenstra and Janssen 2009). This orchestration involves the streamlining of the interaction between governments and firms (but not citizens). It entails coordinating government services and demands towards business, by intelligently establishing institutional structures that coax the different government parties into working together. The firm is regarded more as a "customer" than as a cash cow or an obstruction. This new framework is believed to relieve both governmental organizations and firms of an excessive regulatory burden. The term "chain restructuring" is largely a synonym for this orchestration as well (Taskforce Ketenherinrichting 2007).

Also related is the idea of "public-private partnerships" (Van Woelderen et al. 2006; Koppenjan 2005; Martimort and Pouyet 2008; Schaeffer and Loveridge 2002). In such partnerships, the costs of projects – often infrastructural – are borne partially by those benefiting most from the project, mostly firms. If these public-private partnerships are carried out well, lower costs may be achieved, while projects that otherwise would perhaps not even have been feasible can be tailor-made to fit the needs of important actors. Also, "white elephant" projects that do not live up to their grandiose ambitions are more easily avoided.

Yet, the matching zone is a more flexible concept. As stated before, matching zones may include firms, citizens, or both. Moreover, their objectives need not always be the same; rather, it is the central notion of government-guided discussion and negotiation between different interests that characterizes the matching zone.

A very broad distinction can be made between those matching zones that are instituted on a project base, and those that encapsulate a more wide-ranging array of

responsibilities. *Project-based matching zones* may be invoked to facilitate decision-making on a specific issue, such as the construction of a new airport or a new tax policy. This matching zone may be either for a predefined time period, or for an indefinite period – though "one-shot-interactions" are not seen as matching zones here, as they cannot be regarded as institutionalized framing. *Broad-based matching zones*, on the other hand, are organized more comprehensively around a number of related issues or a fixed number of agents that are involved in a collection of issues. For instance, the Socio-Economic Council (SER) of the Netherlands is a corporatist advisory organ organized around the juxtaposition between trade unions and employers' organizations, with independent members providing mediation and advice on most issues of concerns to employers and employees (see e.g. Visser and Hemerijck 1998, p. 93). This case quite clearly illustrates the role of experts who facilitate reaching compromise agreements.

A second dichotomy is based on whether the matching zone is organized for a known and specified amount of time or for an undefined period – or even permanently. While project-based matching zones may be both finite and permanent, broad-based matching zones are unlikely to be finite. The duration of a matching zone is quintessential to its functioning, given that participants will take into account the benefits and costs of future cooperation and conflict. Generally, a longer duration can be expected to generate more cooperative outcomes. It implies, as will be elaborated later, that the discussions and compromise formation become part of a repeated game. However, matching zones of a limited duration may also be valuable when the project does not lend itself well for long-term evaluation, for instance.

A last distinction that can be made is whether the matching zone is geared more towards distributing costs and benefits, or towards regulation. When a matching zone is focused on costs and benefits, the form and shape of policies or projects are not part of the debate; rather, financing and (re)distributing gains are at the heart of the discussion. The many public-private partnerships that come into existence to finance infrastructural projects like highways provide an example of this. Often, bargaining about who pays for the highway and where the exit ramps will be located is more important than regulating the maximum speed and the like. On the other hand, regulation may also be an important topic for decision-making. If the government plans to impose new norms for pollution, both firms and households may want to discuss not only the costs and benefits, but also the exact content of regulation. Again in such discussions the trusted opinion of experts may facilitate coming to a compromise agreement with the consent of all relevant stakeholders so that implementation costs of regulation are minimized. Figure 2.1 summarizes these various types of matching zones.

	Undetermined/permanent	Finite
Project-based	Design + execution + maintenance/execution phase	Design phase Design + Execution phase
Broad-based	Corporatism, institutionalized input	Not likely

Fig. 2.1 A typology of matching zones

2.2.2 Project-Based Matching Zones

Often, matching zones are created around new, government-instigated projects. For instance, the building of a new airport usually involves a great number of stakeholders, some of which may be disadvantaged by the airport, while others profit from it. Since the issues arising from such projects are unlikely to be tackled in a single meeting, there may be a need for sustained discussion between interest groups. Characteristic of such a project-based matching zone is that it involves only a relatively limited number of issues, all strictly arising from the project itself. It would, for example, not be acceptable for firms to complain about high municipal taxes when the matching zone is focused on the building of an airport.

Every project of this kind has three phases: (1) the design phase, (2) the execution phase, and (3) maintenance and revision (Bovens et al. 2001). One of the prime questions facing policy-makers when setting up a matching zone is which of these phases to include. In general, the design phase will almost invariably be included, since it is often the most fundamental phase of a project. An exception is when the project has already been carried out; e.g., if a highway has already been built. It is, however, a well-known fact in the administrative sciences that plans may still be prone to substantial change, sabotage or even hold-up during their execution (Bovens et al. 2001). Hence, both firms and citizens may insist that the execution phase also be included, as a check on the actual implementation of plans. In the last phase, when the project has been executed, the issues for discussion are maintenance and minor changes. Agents may then be interested in such issues as the division of costs and benefits, and regulation. If these issues are important to the actors involved, a matching zone may be created for an undefined time period, rather than until the end of a given phase. However, the project may also be subject to major ex post revision; for example, an airport may want to build another runway. In this case, the project goes back to the drawing board, and the cycle starts again at the design phase. If major revisions are frequent, extending the matching zone to an undefined stretch of time may also be attractive to policy-makers. As such, project-based matching zones may vary from relatively short but institutionalized meetings between those affected, to infinitely running platforms to discuss design, execution and revision of projects. Here the role of independent experts is to design an appropriate institutional setup of the matching zone, where during the project the discussions with the stakeholders take place so that there is a

broad support for the way the project is executed. Moreover, their role can also be to moderate discussions in an efficient and cooperative fashion.

Project-based matching zones may discuss a wide range of issues. In general, these issues can be subdivided into the following broad categories: (1) design, (2) regulation, and (3) finance. Design corresponds to the physical attributes of the project: For instance, when building a new business park, the matching zone may discuss such issues as the total area of the park, the number of parking lots, or the exact location. Such design issues are often the hardest to change after execution, hence giving the participants an incentive to bargain aggressively about them. Regulation refers to the rules governing the project. Hence, when building a new airport, a matching zone could decide on a noise pollution cap, or on a limited number of aircraft slots. Not only are regulations easier to change afterwards, they are also subject to changing trends, as demonstrated by changing safety rules for nuclear reactors, for instance. Issues of finance, lastly, are comprised by arguments over the division of direct costs and benefits: who pays for what, and who gets part of the incomes or profits generated? This is where expert knowledge comes in handy: independent experts will know which issues to address and how to discuss them. Moreover, they may have specific knowledge on matters of finance which the stakeholders in the discussion do not have.

2.2.3 Broad-Based Matching Zones

While consultation of civil society and business is often confined to specific projects, the realm of politics is also permeated by policy areas where (potential) conflict is more widespread and consultation must be based on a broader foundation. One way to handle such latent or manifest conflicts is through institutionalizing dialogue and negotiation between the opposed parties, and the government. One infamous example of this is the concept of "corporatism", pioneered in Mussolini's Italy and later employed by a wide range of regimes. Corporatism involves the creation of economic and social policy in conjunction with representative groups in society, such as trade unions and employers' organizations. Although the bad reputation of fascism has stuck to it, more transparent and democratic variants have been utilized successfully in advanced economies such as the Netherlands. Such corporatist bodies can also be regarded as matching zones.

There are several reasons why countries have come to institutionalize societal juxtapositions. One reason can be to dampen conflict and to optimize socio-economic outcomes. Through repeated interaction, the encapsulation in the system, and the supervision of the government, social agents may tone down their stance, and focus on cooperation not conflict. Another reason is that governments may want the continued input of societal partners in the policy process, but are not able to do so effectively through non-institutionalized channels. Broad-based matching zones may then provide a government with the means to adjust its policy to the wishes of important groups.

When matching zones are broad-based, they are unlikely to be of a temporary character. Given the wide range of issues, there is no obvious time limit. Moreover, if the matching zone is functioning well, there is no incentive to terminate it after a given period, since it is exactly the repeated interaction that breeds cooperation and trust. It is precisely this cooperation and trust which is needed to bring down the transaction costs of executing projects and implementing policy plans. So a major aim of the matching zone is to enhance the societal support for the project, policy plan or government regulation.

2.2.4 Explaining the Demand for Matching Zones

The coming into being of matching zones in the Netherlands, and similar structures in other parts of the world, corresponds to a need and demand for such apparatuses. There is a wide gamut of circumstances under which ordinary, ad hoc decision-making could be improved upon by such institutions. There are three main reasons to institute a matching zone: *(i)* excessive regulatory pressure, *(ii)* inefficient public services and excessive bureaucratic specialization, and *(iii)* the need to decide on new policy or regulate some specific domain.

2.2.4.1 Excessive Regulatory Pressure

With the expansion of governmental responsibilities since the Second World War, regulatory pressure has increased likewise in many Western societies (cf. Raad van Economische Adviseurs 2005). Both national and regional governments have an increased capacity to regulate society and business, and more and more expertise on regulation. This process has, nevertheless, also led to an explosion of the costs and time that citizens and firms incur in complying with these new rules. From an economic perspective, it is optimal to equate the "marginal returns" of regulation with the "marginal costs" of higher regulatory pressure. This exacts that only "necessary" regulation be implemented. In this case "necessary" regulation can be seen as that level of regulation which repairs market failure or complies with political preferences on redistribution in the most efficient way. However, in the Netherlands, and in many other countries, the feeling is that regulation exceeds this optimal level, leading to excessively high costs of regulation.

There are three theoretical mechanisms to explain this. One of these is that the benefits of regulation often accrue to the regulators themselves, while the costs of regulation are not borne by these politicians and civil servants. This is an argument from public choice theory which leads to a problem of "externalities" in crafting regulation. Matching zones may cause these externalities to be internalized, by passing on part of the costs of regulation to policy-makers.

A second explanation is the exponential effect of rules on regulatory pressures: research shows that new rules breed even more rules (Raad van Economische

Adviseurs 2005). As such, the proliferation of rules may be an explosive exponential process: because new rules lead to new and sometimes undesirable behavior, this new behavior is often again corrected by the creation of rules, hence creating a vicious cycle.

A third theoretical mechanism is that rules are often (ab)used by insiders with vested interests. Because of this, the removal of objectively redundant rules is often strongly delayed by those benefiting from them, while the spread of new rules is not slowed as strongly (Raad van Economische Adviseurs 2005). This status quo bias is widely spread and hard to combat by means of incremental policy-making.

The consequences of this increase in regulatory pressure are plenty and varied. The most important effect for business and the economy is an increase in transaction costs: doing business is rendered comparatively more expensive. Financial funds are allocated to unproductive activities, such as filling in forms, rather than physical production. Moreover, rigidities become more widespread, such that the welfare enhancing market forces are less able to do their work.

A second effect is an increase in monitoring costs as part of transaction costs at the side of the government: with every new rule, the government needs more capacity to enforce compliance with these rules. Moreover, new rules can cause popular support for regulation to wither if these rules are perceived as unjust or redundant. In this case, new rules can elicit unproductive behavior, if citizens also live up less to necessary and just rules.

A third negative aspect of regulatory pressure is that overly strict regulation may also slow down innovation. Even though unwanted behavior may be prevented by new rules, the desirable behavior may also be affected. Thus, firms and individuals will be restricted in their behavior and will not be able to innovate as much as they would otherwise.

2.2.4.2 Inefficient Public Services and Excessive Bureaucratic Specialization

One of the propelling forces behind productivity growth, and hence economic growth, is the intensification of labor specialization. As Adam Smith already contended, labor specialization lets tasks be performed more efficiently. However, there is also a downside: increasing specialization asks for more coordination and communication, because congruence between the different modules of a production chain is quintessential for the efficiency gains that come with it. If this congruence is insufficient, specialization may lead to inefficiency and mounting transaction costs, rather than economic progress. This is a well-known phenomenon within many bureaucratic apparatuses: citizens and firms get sent from one department to another, often getting stuck in a Catch 22-type situation. Along the way, economic actors incur high costs, and waste time and effort.

These transaction costs are caused by the fact that specialization has taken place without being accompanied by a fitting organizational structure. Due to this, each employee and department is often working on its own island (Van Veenstra and

Janssen 2009, p. 19). Moreover, as an organization's departments get older, they are often prone to a phenomenon called scope creep, in which the internal objectives stray away from the originally specified goals (ibid.). Several causes can be identified. First of all, governments often employ management techniques that rely on very limited measures of performance. Governmental tasks, however, are often very complex. Thus, incentives arise to focus on the measures, rather than the real goal at hand. This encourages isolation and excessive specialization. Secondly, different parts of a government organization may have their own clientele (Bovens et al. 2001, p. 218). This is often due to intensive contacts between parts of government and their "clients". Because of this, companies often have no problems in dealing with one part of a bureaucracy, while other parts work against them. For instance, firms are the core clientele of Chambers of Commerce in the Netherlands, while civil servants dealing with spatial planning often give more heed to other concerns than business's worries.

Hence, specialization within the civil service (and often also within companies and other organizations) may lead to inefficient policy-making and implementation. Rules are frequently unclear, and firms are told different things by different departments. Starting entrepreneurs and citizens themselves also run into these kinds of problems. This brings about higher transaction costs in the economy. Thus, streamlining bureaucratic processes more often than not is essential. Matching zones can be very helpful in enabling such streamlining, often by forcing the bureaucracy to arrange all contacts with the relevant part of society through one channel. In this setting experts with a broad knowledge of the various government departments, and with knowledge of the stakes and hobbyhorses of the departments, may very well contribute to reaching agreements.

2.2.4.3 New Policies and Projects

New projects and policies often run into "NIMBY"-type problems. Moreover, the original plans are often not geared perfectly towards those that would benefit from it. This may lead to unnecessary delays, inefficient implementation, or a project or policy that simply does not match society's needs. Any project or policy invariably has a number of beneficiaries and a number of disadvantaged groups. Bringing together these two parties before implementation starts is quintessential for optimizing outcomes and minimizing transaction costs. With increasingly vocal citizens and firms, ignoring society is simply not an option anymore. Matching zones can therefore be employed, bringing together the government, firms, and citizens, in order to forestall costs from running high.

2.3 Cases

This section gives four examples of the institutional setup of consultation and stakeholder participation, which can be regarded as successful matching zones. These cases are used in the following sections to illustrate the theoretical argumentation for the design of matching zones in various situations, and to derive practical recommendations for their design.

2.3.1 The Alders Table

Schiphol, one of Europe's busiest airports, is a major driver of the Dutch economy. Many companies are heavily dependent – either directly or indirectly – on the airport. At the same time, however, the endless air traffic elicits much frustration and consternation in the densely populated metropolitan area of Amsterdam. Contributing to this clash of interests are the continuing pressures to expand the airport. In its long-term strategic document of 2007, the Schiphol Group argued that a sixth runway would be paramount to the future economic development of the Netherlands (Schiphol Group 2007). While debate about any expansion of Schiphol had long been contentious, the looming inevitability of some form of extension triggered a more constructive response from many affected parties – negotiating on reasonable terms became more attractive than thwarting any new developments.

From this situation emerged a new forum for discussion and negotiation between the various stakeholders, in which the national and municipal governments, the inhabitants of the affected area, and the parties involved in aviation were drawn together to discuss mutually advantageous solutions.[2] This can be regarded as a matching zone. Rather than summoning all parties for a one-off negotiation about the future of the airport, the Ministry of Infrastructure and the Environment, and the (former) Ministry of Spatial Planning decided to institute a semi-permanent council, which would provide policy-makers of these two ministries with consensual advice.[3] This would all occur under the presidency of former Minister of Spatial Planning and Labour MP Hans Alders – accordingly, the matching zone was dubbed the "Alders Table" (Tafel van Alders). Here Alders, as chairman, obviously fulfilled the role of independent expert who facilitates that agreements between the various stakeholders were to be reached. His experience as a minister and a parliamentarian, with ample experience in resolving planning and environmental issues, endowed him with the necessary knowledge and stature.

In this case the parameters set by the initiating ministries are of special interest. Firstly, the task given to the matching zone was explicitly bound by the need for full

[2] http://www.alderstafel.nl/schiphol/start/

[3] http://www.alderstafel.nl/schiphol/opdracht/

agreement.[4] This included giving heed to the four prime interests of the different participants – further development of the aviation sector, limiting noise nuisance for inhabitants, improving the quality of living for the direct surroundings of Schiphol, and the efficient use of ground space. This specific task had the effect that factions within the matching zone could not span together and ignore other groups. Rather, all participants needed to work together on relatively equal footing, and all had to compromise. Although this could have led to small groups hijacking the debate by threatening with a veto, this seems not to have occurred – quite possibly because of the necessity to cooperate in the future.

Secondly, a specific deadline was given to complete the first assignment: The Alders Table was asked to provide an advice for the medium term before May 2008.[5] This created the necessary pressure to coax the participants into compromise and to avoid the usual procrastination and bickering. Of course, it is also possible that this deadline negatively affected the quality of the advice, although this would be hard to establish empirically.

Thirdly, the set of possible outcomes was limited from the onset by the ministries. Six different policy alternatives were given, leaving it up to the matching zone's actors to favor one over the other – although hybrid forms were allowed.[6] This selection of a limited set of alternatives effectively reduced the number of issues on which the participants could disagree. Also, endless quarrels about procedures and the order of discussion were avoided. Moreover, debate was tightly focused on the issue at hand, so that vaguely related issues were avoided. Also, the discussion was confined within the set of policy options that were deemed feasible and desirable by the two cooperating ministries. The flipside of this is, of course, that more creative solutions were avoided and that productive "horse trading" was quite hard.

Fourthly, the number of actors in the matching zone was heavily restricted. As such, the companies operating at and around Schiphol were not invited. Also, citizens suffering welfare losses were only invited to join through two interest groups, the Commission for Regional Discussion on Schiphol Airport (CROS) and the Society for Common Platforms (VGP). Moreover, municipalities that were only affected mildly by the expansion of Schiphol were not included, as well as NGOs focused on environmental preservation.[7] This facilitated efficient discussion and decision-making, and made it less arduous to keep all participants in check. However, it also provoked a backlash: entrepreneurs in the vicinity of Schiphol have complained extensively about their exclusion, and eventually came up with an alternative Alders Table – the so-called Economic Table for Schiphol (ETS) – in

[4] http://www.alderstafel.nl/schiphol/opdracht/

[5] http://www.alderstafel.nl/schiphol/opdracht/

[6] http://www.alderstafel.nl/schiphol/opdracht/

[7] http://www.trouw.nl/tr/nl/4324/Nieuws/article/detail/1201545/2008/12/04/Aan-de-Tafel-van-Alders-zijn-te-weinig-plaatsen.dhtml

November 2010. Thus, although efficacious discussion was facilitated by excluding actors, legitimacy also suffered.

Up until now, the Alders Table seems to have performed quite satisfactorily. The advice of 2008 was taken up by the government, and subsequently implemented.[8] Even the business alternative, the ETS, admits that the Alders Table works well.[9] Moreover, the Alders Table has resulted in the establishment of two additional matching zones with a similar task. These perform the same role, but with respect to Eindhoven Airport and Lelystad Airport, both deemed to be important future alternatives to the expansion of Schiphol. The Alders Table has also, however, been criticized for its lack of representativeness and lack of openness.[10] Although this critique by left-out, disgruntled stakeholders may very well be fair, it seems not to significantly have undermined the effectiveness of the matching zone.

2.3.2 The Social Economic Council (SER)

The post-bellum period in the Netherlands saw a strong determination to build up the country, rather than getting bogged down in class struggle between various interest groups in the socio-economic debate on policy matters. This led the government of Prime Minister Willem Drees to institute a "social economic council" in 1950 – dubbed the Sociaal-Economische Raad (SER) in Dutch.[11] In fact it is part of what can be called the industrial organization of policy preparation in the Netherlands (see Den Butter 2011). This council was set up to bring together trade unions, employers' organizations and so-called independent "crown members" in a tripartite, permanent institution. Although this institution preceded the concept of what this chapter labels "matching zone" it can be regarded as a prototypical one: it provides a well institutionalized framing of consultation in order to prevent societal clashes of interest and to come to compromise agreements. The principal task with which the SER has been entrusted is advising the government; although the government is not obliged to follow this advice, it is legally expected to consider it and provide a formal reply. Yet in most cases the government will indeed follow the advice as policy measures approved in the advices of the council will meet broad support when implemented.

There are a number of features that set the SER apart as a public institution. Firstly, the inclusion of independent crown members – members appointed by government decree – provides for a conciliatory and objective factor. Whenever the unions and employers dig their heels in the sand, they can facilitate a

[8] http://www.depers.nl/binnenland/181734/Nieuwe-vertrekroutes-Schiphol.html

[9] http://www.vlieghinder.nl/reacties.php?id=P5813_0_1_0

[10] http://www.trouw.nl/tr/nl/4324/Nieuws/article/detail/1201545/2008/12/04/Aan-de-Tafel-van-Alders-zijn-te-weinig-plaatsen.dhtml

[11] http://www.ser.nl/nl/Raad/Tijdbalk.aspx

breakthrough. Moreover, since many crown members are renowned scientists (including the president of the Dutch Central Bank and the director of the Central Planning Bureau), the SER benefits from recent scientific breakthroughs. In fact these crown members act as experts which are instrumental to reach agreement on the advices amongst the social partners. A major advantage of such experts joining the discussions in the SER is that they urge the participants from the social partners to base their arguments on solid scientific insights. It brings discipline to the discussions. For instance, the model based policy analysis of the Central Planning Bureau plays a major role in the macro-economic policy debate in The Netherlands (see Den Butter 2011). In their interventions in the SER all stakeholders are forced to frame their contributions in terms of this policy analysis. This may help to formulate optimal policies. Expert civil servants from the policy departments of the Ministries also attend the discussions in the SER but have no say. Formally this is correct as the government asks the SER for advice and it would be improper as representatives of the government would interfere in the discussions. However, through informal channels, and in consultation with the independent members, expertise at the Ministries may have its influence on the final compromise.

Secondly, by its permanent nature, the SER is likely to maintain its existence and prominence for many years to come. This brings a strong "repeated game" element into the relationship between its members. Both unionists and employers are perfectly aware that they will be dependent on each other in the future. This often breeds cooperation and concession politics (see Den Butter and Mosch 2003 for a further discussion).

Thirdly, the selection of participants is narrow. Three trade unions and three employers' organizations form part of the SER, hence giving them favored access over other, alternative organizations. On the one hand, this may lead to rigidity, especially in a country where union membership is quite low and where labour and capital are not always the central juxtaposition in the economy anymore (Visser and Hemerijck 1998, p. 100). The SER has thus been criticized for not responding to a changing society, while the trade unions specifically are often scolded for being unrepresentative. On the other hand, however, the efficiency of the policy process is greatly helped by not bringing in too many actors and by keeping interests clear. Moreover, it has been argued that the system encourages the trade unions and employers' organizations to look beyond their narrow constituency, and take into account the broader needs of society from the macroeconomic perspective.

Fourthly, casual contacts between the SER members are very common. Since the SER is interwoven with a number of other institutions and organizations, its members often see each other frequently on both a formal and an informal basis. It has been argued that this has led to a high degree of mutual trust among SER members, thus facilitating cooperation. There is, of course, also the critique that this has rendered the SER into an "inbred clique" that does not represent society's interests sufficiently and is slow to make decisions. Yet, as the independent members of the SER are also part of these formal and informal networks, their influence on consensus and compromise formation is also exerted through these channels.

Fifthly, there are a number of incentives that encourage reaching compromise agreements on the advices. One relatively recent development is the scrapping of the government's obligation to ask for the SER's advice on every single social or economic measure it takes. While beforehand this was widely expected to reduce the SER's influence, its actual effect was the opposite: because the Council now often had to give "unwanted" advice in order to influence government policy, the need for a coherent and consensual position was even greater. This led the SER to become less divided and more efficacious in its formulation of policy advice. Another important device that induces compromise agreements is the fact that both the trade unions and the employers' organizations have a number of sticks and carrots to employ. Trade unions have an official (conditional) right to strike, but also to sign collective agreements in name of all employees. Employers' organizations can decide to hire and fire workers, but are also able to represent the whole gamut of employers in collective bargaining. This enables both parties to issue credible threats *and* credible rewards, thus making cooperation more enticing.

Of course, the SER is no panacea for all economic ailments. Specifically, during the 1970s the Council was rife with division and disputes. During this time, the SER was often one of the many arenas in which unions and employers were slinging mud at one another. However, in the 1980s a new consensual mode was found, partly in response to the economic problems afflicting the Netherlands. In the two following decades, the so-called "polder model" became commonplace, in which societal groups aimed at mutually beneficial outcomes and not at conflict. This is reasoned to have produced significant economic gains, and above all a high degree of mutual trust within political and economic institutions, amongst which the SER was prime. Hence, the SER played a key role in promoting a political economy in which transaction costs in socio-economic collective bargaining were low, while outcomes were relatively optimal. In this sense, the Council's function as a "matching zone" is often evaluated quite positively, albeit that long delays in reaching compromise agreements are sometimes also regarded as hindrance to the process of policy making. Moreover, in recent years internal disputes within the trade unions have weakened the role of the Council.

2.3.3 Participatory Budgeting in Brazil

A somewhat more exotic variant on the matching zone can be found in contemporary Brazil: the so-called *orçamento participativo*, or "participatory budgeting". Responding to pressure for more local democracy in the end of the 1980s, the socialist PT party in the southern city of Porto Alegre implemented a radical new way of setting the municipal budget (Kunrath Silva 2003, p. 165). The idea was to involve citizens in the budgeting process, thus enhancing spending efficiency and popular representation, and reducing graft and waste. While political power has swapped hands ever since, the *orçamento participativo* has continued to play a key role in Porto Alegre's politics, and has even been copied in a great number of other

Brazilian cities. It is an interesting case to study because the prefecture of Porto Alegre has managed to effectively bring together citizens and the government, while keeping transaction costs down.

The *orçamento participativo* in Porto Alegre has evolved throughout the past two decades, but the underlying principle has remained the same. Each of the 16 subsections of the city has its own plenary meeting, and there are five thematic plenaries: Transport; Education, Culture and Leisure; Health and Social Assistance; Economic Development and Taxation; and City Planning and Urban Development (Fedozzi 1998, p. 259). In each of these institutional structures, there are three phases, with the budgetary choices and number of participants being narrowed down in each subsequent phase. There is an annual cycle. The most important axis of negotiation is between the government and different groups of citizens. Hence, the *orçamento participativo* can safely be regarded as an example of a matching zone, in which the government attempts to align its own objectives and interests with those of a wide gamut of societal actors.

Some institutional features set the *orçamento participativo* apart from other matching zones. First among these is the "funnel-shaped" structure of meetings, consisting of the aforementioned three phases (see Fig. 2.2). In the first phase, *all* citizens of the age of 16 and above residing in the area are allowed to join the meetings. In this phase, participants are presented with the outlay of the part of the budget that is designated to be decided upon by the *orçamento participativo*. (Since the prefecture also faces fixed costs, it cannot allot the whole budget to the assembly.) They jointly decide on the criteria and emphases that should apply to the eventual allocation of the budget. Most importantly, they decide on the division of popular delegates per neighborhood, who will then further their interests during the rest of the budget process.[12] In the second phase, things get more detailed, as the assembly decides on the policies and projects that will be enacted during the coming fiscal year. At this stage, all participants are still welcome, but a higher level of knowledge about the budget is expected and necessary to follow the discussions. During this phase, the popular delegates are actually elected, and will start consulting their constituents about policy. In the third phase, finally, only the delegates and government officials are allowed to join the discussion – the so-called Budgetary Council (Fedozzi 1998, p. 255). In this phase, debate gets quite technical, and the delegates are expected to be knowledgeable about the issues on the table. Effectively, this is where the experts get into the game, as representatives are often weathered in the specifics of their decision-making areas.

In practice this funnel model tries to achieve a balance between popular legitimacy and efficiency. While the initial phase leaves plenty of room for "agenda-setting" on the part of ordinary people, the election of representatives in the later phases prevents the process from becoming slow and murky. Moreover, the yearly election of these delegates makes sure that there is competition and that the assembly does not become detached from its social environment. In practice, this

[12] http://www.partizipation.at/fileadmin/media_data/Downloads/themen/A_guide_to_PB.pdf

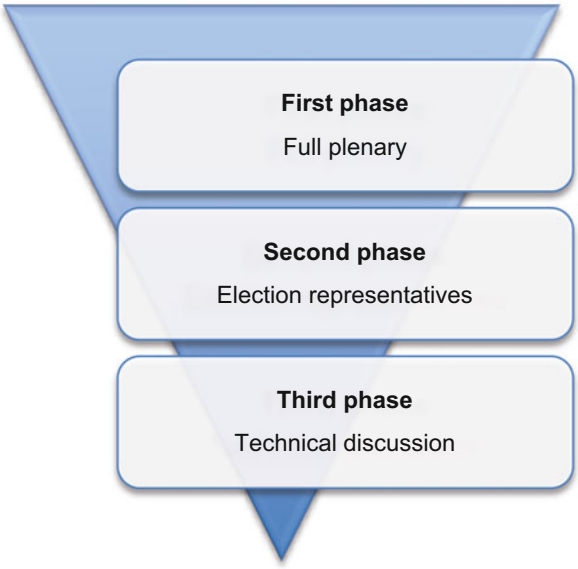


Fig. 2.2 The funnel model

has worked out well: the *orçamento participativo* has been widely hailed as an example of efficient but fair policy-making. In short, transaction costs have been kept low.

A second characteristic of participatory budgeting in Porto Alegre is that there are also constraints on the delegates (Kunrath Silva 2003, p. 172). Beforehand, the prefecture compiles a concise list of criteria to which the eventual budget should adhere. Since government officials also have a vote in the meetings, they are keen on monitoring adherence to these criteria. Moreover, there is the requirement that expenditures and incomes add up to zero, eventually. Hence, delegates cannot spend at will, but have to take into account financial constraints. Moreover, there is a strong incentive to produce consensus, as any failure to come to a conclusion will make the representatives come off as irresponsible and not worthy of re-election. In general, debate is cooperative and past assemblies have always managed to come to a consensual budget decision.

A third element is that, even while delegates take over during the third phase, the whole budget process is transparent and accessible. This has strongly diminished the opportunities for misapprehension of funds, collusion among delegates, or "blackmailing" from the side of the government. Moreover, it has increased the popular legitimacy of the process. Although it also means that every delegate is subject to scrutiny, and that there is thus an incentive to get as big a piece of the cake as possible, this seems not to have produced any problems in general, and is viewed as an essential element of these matching zones.

The result of this way of organizing the budget process is that, rather than making decision-making tedious and opaque, the inclusion of citizens may actually render the formulation of policy more efficient and just. Social and economic

indicators in Porto Alegre seem to support the efficacy of the *orçamento participativo*, as the city strides forward where other Brazilian cities – such as Rio de Janeiro – struggle (Baiocchi 2006, p. 2). The key is to create a strong institutional foundation, with clear rules and a thought-out way to balance representation and efficiency. In this case the role of experts to come to compromise agreements differs somewhat from the other cases. Here, in a way, the "experts" are delegates which are sufficiently knowledgeable to follow the technical discussions in the third stage of the funnel model.

2.3.4 Imports of Animal Nutriments

The import of foodstuffs of animal origin, such as meat and fish, is often a cumbersome process, due to a plethora of (phyto)sanitary, logistical and legal regulations. Importing such foodstuffs through the port of Rotterdam involves a great many organizations, ranging from ship-owners to container-movers, from governmental sanitary institutions to the port of Rotterdam itself, and of course the customs authorities[13] In this production and logistic chain, many things can – and do – go wrong, slowing down trade.

To deal with this, the Dutch customs authorities initiated a matching zone – here the label of matching zone ("koppelzone" in Dutch) was in fact used (Boerma and Troquay 2010). It was set up in cooperation with a number of business organizations and governmental institutions, among which the prime Dutch government organization for sanitary and phytosanitary inspection, the Food and Consumer Product Safety Authority (VWA).[14] This was done under the aegis of the government organization specialized in matching-zone-type institutions, "Slim Geregeld, Goed Verbonden" (SGGV). The aim of the matching zone was to reduce transaction costs for Dutch importers of animal foodstuffs.

This matching zone has three striking characteristics. First, the project gravitates around the introduction of a specially developed piece of software, *Supd@x,* which centralizes all the necessary requests for importing animal products (IVW 2010, pp. 8–9). Thus, the project reaps the full benefits from IC technology. Cumbersome paperwork is avoided and there is one central database in which all the parties involved can find what they need. Also, the set of information that needs to be provided was broadened (Van Veenstra and Janssen 2009, p. 40). Paradoxically, this seems to have reduced transaction costs, because "follow-ups" for more information are now less frequently needed.

Second, from the government's point of view, responsibility is centralized and vested in the customs authorities. These authorities manage the matching zone and can thus be seen as both the mouthpiece and the director of the institution. This has

[13] http://sggv.nl/casussen/sggv-in-een-wereldhaven/omschrijving

[14] http://sggv.nl/casussen/sggv-in-een-wereldhaven/omschrijving

two advantages: (i) firms only have to deal with one organization, and (ii) there are clear and hierarchical lines of responsibility, thereby preventing "bureaucratic isolationism". Apparently here government officials chair the negotiations in the matching zone, although they may rely in technical matters, and also in matters of institutionalizing the discussions, on help by independent management consultants as experts. That is how in this case the input of experts is organized in order to come to compromise agreements.

Third, the rules for importing have been made more flexible. Because the production and logistic chain is more integrated and coherent, there is less need for burdensome rules, and more space for the careful interpretation of regulations. As such, both importers and government authorities were relieved from the burden of checking minute details.

Although only installed relatively recently (starting in 2009), this program seems to function well. The partners in the chain have decided to extend the Supd@x program to other forms and modalities of import, such as Schiphol Airport (ICTU 2011). Total reductions of costs have been estimated to be around €6 to €8 million per year.[15] A striking feature of this matching zone is that particular attention has been paid to the management of information streams (Van Veenstra and Janssen 2009, p. 43). This corresponds with the idea that one of the prime objectives of instituting a matching zone is to facilitate the easy flow of information.

2.4 Theoretical Framework: The Added Value of Matching Zones

Matching zones offer a number of advantages over the usual *status quo*. The theoretical basis for these advantages is broad, ranging from simple economic mechanisms to issues of justice. This section seeks explanations from the theoretical perspective why the previous examples of matching zones worked well.

2.4.1 Externalities

Externalities, both positive and negative, play a major role in a modern densely populated society with much social and economic interaction and entanglement. The more players with different objectives and incentives there are, the larger these externalities will be. Hence, interactions with such diverse actors as governments, firms and citizens will tend to be replete with inefficiencies due to externalities causing welfare losses. An example of a negative externality discussed before is the incentive for civil servants to increase regulatory measures, while not having to

[15] http://www.inspectieloket.nl/domeinen/zeehavens/projecten/supdx2010615232822.aspx

incur the costs of these. Externalities between citizens and firms also abound: pollution, use of infrastructure, but also monopoly pricing are examples of these kinds of market failures.

The issue with externalities is that economic agents' rational, self-interested behavior is not aligned with the "social optimum". Hence, if agents were to align their behavior with the public interest, they could attain a higher overall welfare. This alignment, however, is subject to what is often called "collective action problems", because every agent will still have an incentive to free-ride on others. The key feature of *matching zones* is that they enable participants to overcome these collective action problems and hence internalize externalities. The role of experts in the different settings of the matching zones is that they may enhance the awareness of the various stakeholders in the matching zone of these externalities. Thus, achieving higher welfare will often be possible through coordinating actions. There are four different types of such economic improvements, which are discussed below.

2.4.2 Economic Welfare Improvements

From the perspective of compromise agreements in discussions on welfare gains from projects and policy plans where different stakeholders are involved, there are two main axes on which the analysis of efficiency improvements should be based:

1. Do all parties involved gain instantaneously from the improvement in efficiency?
2. Is there any redistribution of economic means after the improvement?

Please note that "dynamic efficiency" is not considered here; merely "static efficiency gains". If one combines these two axes, the typology of economic welfare improvements is obtained as depicted in Fig. 2.3.

The implications of these different types of economic improvement can differ vastly. The following list gives a definition of each of them and some examples.

- *Clash of interests*. When an improvement leads to a loss for at least one party, while overall welfare and efficiency increase, then one can speak of a "clash of interests". This will often spark conflict and discontent on the side of the disadvantaged parties. A classic example is that of the "enclosure movement" in England in the late eighteenth century: Rich landowners (forcefully) appropriated land from poor peasants, who were not compensated for this and thus ended up worse than in their initial situation, even though enclosure is often praised for bringing about higher efficiency in agriculture.
- *Pareto improvement*. If an improvement can be made with all parties better off in an absolute sense, then we have a Pareto improvement. Since all economic agents gain, they are assumed to agree with such a solution. There are, however, two caveats. First, issues of fairness can and do play an important role in

Do all parties gain?	***Ex post redistribution?***		
		Yes	*No*
	Yes	"Fair" Pareto improvement	Pareto improvement
	No	Kaldor-Hicks improvement	Clash of interests

Fig. 2.3 A typology of economic welfare improvements

bargaining, even if economic theory does not predict so. We will further discuss this under the "fair" Pareto improvement. Second, Pareto improvements are not as common as one would like them to be. Specifically, it is often posited that countries in an advanced stage of development have "picked the low-hanging fruit" – i.e. obvious Pareto improvements.[16] An oft-cited example of a Pareto improvement is the introduction of the intermodal ISO container for freight ships (although even this advance may have disadvantaged some parties).

- *Kaldor-Hicks improvement*. Because of the relative rareness of Pareto improvements, in practice the (re) distribution of the welfare gain will more often be subject to the "Kaldor-Hicks criterion". If some economic agents lose out initially, but can be compensated *ex post*, then a situation may move towards Pareto efficiency without any agent objecting. This is, however, subject to critique: for instance, Stringham (2001) remarks that a government would need to be impossibly knowledgeable if it is to apply this criterion in general equilibrium. Nonetheless, there are plenty of instances in real life where this principle appears to have worked: providing inhabitants of seedy neighborhoods with new housing, so that the neighborhood can be rejuvenated, is a fine example.
- *"Fair" Pareto improvements*. Even if all parties gain from a Pareto improvement, some may gain far more than others. Different from what orthodox economic theory suggests, people often do place a strong weight on the fairness of a process and its outcome, even up to the point of opposing measures that would have made them better off in absolute terms (Husted and Folger 2004). This is why "fair" Pareto improvements are also a possibility (please note that the notion of "fair" is open to considerable debate and that this chapter will not try to provide a definition for it). In this case the discussions in the matching zone are confined to come to a "fair" distribution of the welfare gains from the project or policy measure.

[16] http://www.economist.com/node/18276872?story_id=18276872

Repeated interaction?	Hierarchic ?	
	Yes	*No*
Yes	Matching zones	Repeated games
No	Government consultations	One-shot transactions

Fig. 2.4 Different types of economic interaction

2.4.3 Types of Economic Interaction

The above typology suggests that there are different types of outcomes in achieving efficiency. At least as important, however, are the *means* through which such outcomes are reached. Figure 2.4 illustrates the two main questions that are to be answered in this case.

Thus, matching zones are asked for if there is a need for both repeated interaction/institutionalization and for enforcement of the agreements. Through this potent combination, it is possible to internalize externalities and come to agreements that are perceived as fair and mutually beneficial.

2.4.4 Transmission Mechanisms

Matching zones thus have two major advantages in public policy. Firstly, they reduce transaction costs when trying to achieve economic welfare improvements through projects and policy plans. Secondly, they lower the chance of hold-up problems and reneging on agreements *ex post*.

There are at least three transmission mechanisms through which these improvements are achieved, and which give matching zones an edge over the other forms of coordination in a great number of situations:

1. Enforcement of agreements
2. Repeated interaction
3. Actor participation and fairness

2.4.4.1 Enforcement of Agreements

Agreements between parties are often prone to cheating, lying and outright reneging. If a firm has an agreement with a group of citizens that it will cut its noise pollution in return for citizens' backing of an expansion of the firm's premises, it may be tempted to simply ignore the citizens after they have given their consent. Similar situations are common in one-off interactions between firms or between citizens. This is especially the case if the agreement has not been put in writing, or if

the legal system is not well-suited for enforcing the specific agreement. The involvement of the state may thus make compliance more likely, since it is the only body able to truly enforce agreements, by virtue of its sovereignty.

An issue here is the trustworthiness of government itself. While higher layers of government will usually stick to their promises, given their high visibility, lower layers (e.g. municipal or provincial governments) are much more able to fly under the radar, tempting them to renege on agreements. An essential feature is thus citizens' ability to enforce agreements made with the state through the courts. While this feature of constitutional law is usually enshrined quite well in many advanced democracies, it is an essential feature of matching zones.

In order to show how to model the enforcement aspect of matching zones, the example of an agreement between a firm and a group can be used. The firm and citizens can either strike an agreement or fail to produce consensus (see Fig. 2.5). If the two parties cannot make a deal, the status quo ensues, leaving each party with a payoff of 0. If they do strike a deal, the citizens are assumed to make the first move – e.g. consenting with an expansion of the firm.[17] Subsequently, the firm has to decide whether it lives up to its promises, or does not comply. If it does comply, a mutually satisfactory outcome (A, A) results. It is also possible, however, to ignore the citizens and achieve the higher payoff C. Since this was not the citizens' intention, they obtain a lower payoff B. Hence, we have the payoff profile (B, C), and the following ranking:

$$B < A < C$$

It is obvious then, by backward induction, that the group of citizens will not even strike an agreement if $B < 0$. Since the citizens make a concession, while the firm sticks with the status quo, this must be the case by definition. Hence, the mutually advantageous cooperation will be impossible to achieve.

The question now is about the role of the government in this game. The government can drastically change the payoff profile of the firm through either financial or non-monetary punishment of reneging on agreements. Let this punishment be denoted by F. Then, the total payment for the firm if it does not comply will be $(C-F)$ instead of C. Hence, for the punishment to be effective, the following condition must hold:

$$(C - F) < A \quad \text{or, equivalently,} \quad F > (C - A)$$

Hence, if the government is sufficiently successful in convincing parties that non-compliance leads to severe punishments, then it may be able to induce

[17] Please note that the below argument works symmetrically; i.e. it could also be the firm that makes the first move, and the citizens that decide whether to comply or not.

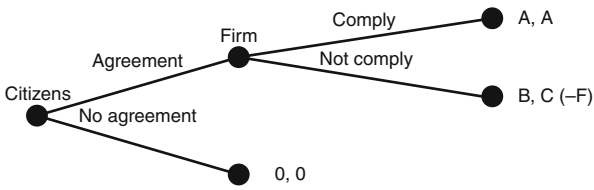


Fig. 2.5 A cooperation game

cooperation. Specifically, the institution of a matching zone is well-suited for guaranteeing this kind of government oversight.

2.4.4.2 Repeated Interaction

It is common knowledge that it is often easier to cooperate with people one thoroughly knows than with complete strangers. Part of this is due to human nature: we tend to feel more at ease when we are used to somebody's ways and rarities, and when we know what to expect. Perhaps equally important, however, is the notion that repeated interaction breeds cooperation through the incentives that future cooperation brings. Since matching zones are institutionalized as long-run mechanisms for convening, all participants know that they will have to negotiate about more than just the issue on the table. A necessary condition for a cooperative outcome, however, is a sufficiently patient attitude of the participants.

A way to formalize this is to model the interaction as a repeated game. Like the previous game, we call the cooperative gains A, the gains for the firm from reneging C, and the payoff for the citizens if they are being cheated is B. The difference is that, this time, the game is played an infinite (or, equivalently, unknown) number of times. If one of the agents does not keep its promise, the other one is not willing to cooperate anymore for the rest of the time. We then have the following payoff per actor, assuming the discount factor δ:

$$\pi^{Firm}_{Cooperate} = A + \delta A + \delta^2 A + \delta^3 A + \cdots + \delta^\infty A = \frac{A}{1-\delta}$$

$$\pi^{Firm}_{Cheat} = C + 0 = C$$

So for the firm, we have the following condition:

$$\delta \geq 1 - \frac{A}{C}$$

In words: the larger the gains from cooperation, the more likely cooperation, and the larger the gains from cheating, the less likely.

2.4.4.3 Fairness and Transaction Costs

In transaction cost economics, the "fairness" of transactions is often not an issue. Only absolute gains matter, not relative distributions. In reality, however, most people react strongly to matters of fairness and justice. If governance does not take this factor into account, transactions costs may quickly run high (Husted and Folger 2004, p. 719). Economic actors will not be willing to make economic exchanges, or may be slow in ascertaining the implications, and will thus falter in deciding.

One can identify two forms of fairness: procedural fairness and outcome fairness. Procedural fairness refers to the notion that people want a *say* in the outcome; even if the eventual result isn't to their liking, they will still have the feeling of being heard (ibid., p. 725). This includes such factors as respect, telling the truth, trust, etc. When such procedural fairness is not present, participants are more likely to hinder the functioning of the governance mechanism (ibid., p. 726).

Outcome fairness, on the other hand, is an assessment of the situation *ex post*. Having a voice in the outcome is not essential; rather, what is important is that participants get their "fair share" of the pie. This is up to every participant's individual, subjective judgment. However, there are often general principles guiding the perceived fairness, such as proportionality, need, merit, and the like. If a governance system does not generate such outcomes, it is more likely to have high transaction costs or even to fail (ibid.).

Matching zones may provide for both of these types of fairness. Procedural fairness is achieved if actors get a say in the decision-making process. This relates to the "funnel model" discussed in the context of Porto Alegre's *orçamento participativo*. Outcome fairness is also more likely, because parties often have a veto or strong bargaining power in the matching zone. Hence, it is harder to exclude important economic agents. Therefore, making fairness part of the considerations in the matching zone negotiation should lead to lower transaction costs.

The considerations to include the concept of fairness in the discussions and negotiations between stakeholders in the matching zone are much related to the lessons from a positive economic theory of fairness. This theory and its practical examples illustrate how the perception of fairness between the various stakeholders can be framed in such a way that there is a divergence between individual non-cooperative rationality and group wealth maximization (Isaac et al. 1991). In other words, the (re)distribution of welfare gains from a project or policy plan must meet the test of fairness shared by all participants in the discussions and negotiations. That will enhance the societal support for the project or plan and reduce the transaction costs considerably.

2.5 Learned Lessons

The empirical cases we have seen above and the theoretical considerations of matching zones bring to light a number of lessons that can be drawn for the real-world application of matching zones. While every problem needs its own bespoke matching zone, a number of broad principles can be identified that will work almost invariably. These principles can be organized into three categories: those at the strategic level, at the tactical level, and at the operational level. Together, these lessons are essential to a well-functioning matching zone.

They are not, however, sufficient conditions. As always, the devil is in the details, and matching zones will have to be adjusted to the specific subject, political playing field, and local culture. As yet, the notion of the matching zone shows that much can be achieved through institutional innovation. It is therefore highly recommendable to experiment with different forms of matching zones, in order to find out what works best in a particular setting.

2.5.1 The Strategic Level: When to Use a Matching Zone

The most important decision to make when it comes to matching zones is whether to institute a matching zone at all. In this decision, the government needs to take into account its own capabilities and wishes, and those of societal actors. A prerequisite is that the matching zone must *add value*: it should provide for an improvement over the status quo or any alternative institutional set-up.

Broadly spoken, a matching zone is only a desirable option when one or more of the following three conditions are fulfilled:

1. The government has trouble fulfilling its obligations towards society satisfactorily, due to a lack of coordination with societal actors
2. Societal actors have trouble fulfilling their obligations towards the government satisfactorily, due to a lack of coordination with the government, and/or due to a lack of coordination between governmental departments
3. Representation of important affected parties is indispensable, due to popular demand and/or likely obstruction of implementation by these parties

If the government is unable to perform its services towards its citizens and firms in a decent way, it may be opportune to institute a matching zone. This depends on whether such a dysfunctional performance is due to a lack of consultation of the government's clientele and affected actors. For instance, if a local government is responsible for handing out subsidies to small enterprises, but these subsidies do not find their way to these kinds of businesses, it may be wise to set up an institutional consultation of such businesses to improve the government service.

In the same fashion, if firms or citizens have trouble complying with the government's requirements, such as paying taxes or administrative duties, a

matching zone may help. If communication between the government and society, or within the government internally (and thus ultimately with society), is lacking, institutionalized consultation may help to improve the flow of information and reduce the burden of government rules and requirements.

Representation is almost inevitable in modern democratic societies. This may be due to the public's opinions on representation (i.e. a call for legitimacy) or because the concerned actors may frustrate the implementation/execution of policy. If such is the case, a matching-zone-type construction is desirable for both practical and ethical reasons. For instance, now that Lelystad airport is to be expanded, it would be highly reasonable to have an institutionalized consultation mechanism including the affected people and businesses.

If at least one of the three conditions stated above is fulfilled, and if there is no better, cheaper or more efficient way to solve the problem, then setting up a matching zone is strategically desirable. Although this cost-benefit analysis is hard to quantify in practice, it is essential that policy-makers give sufficient thought to these requirements.

Developing and highly divided societies bring along added difficulties in instituting matching zones. Where trust in government institutions is low, the division between labor and capital is strong, or short-term thinking trumps long-term cooperation, matching zones are more likely to fall apart. For example, many Latin American countries have institutions where the government, trade unions and employers' organizations are brought together, yet these councils are rarely more than another arena for scolding each other. Nonetheless, these sorts of situations also offer the largest improvement over the status quo, since the initial situation is often one of virtually no dialogue. In that respect, the example of Porto Alegre's *orçamento participativo* shows that employing matching-zone-style institutions is far from impossible in these countries.

2.5.2 The Tactical Level: How to Design a Matching Zone

If the government decides to institute a matching zone, the ensuing question is: how to design it? The preceding cases and theoretical analysis have revealed six guidelines for matching-zone design:

1. Create an incentive for reaching an agreement
2. Create the expectation of repeated interaction
3. Strike a balance between representativeness and efficiency
4. Institute impartial arbitration (e.g. by participation of experts)
5. Make clear what the constraints are
6. Properly use IC technology

First of all, there must be a strong incentive for reaching an agreement. This can be achieved through a formal need for unanimity on the agreement – i.e. every participant has a veto –, or by making clear that any decision based on a small

majority will be discarded by the government. This principle prevents factionary politicking and implementation problems afterwards. There is, however, a trade-off between unanimity and efficiency, since a veto implies excessive bargaining power. Hence, if full unanimity is unattainable, the matching zone should aim for as large a majority as possible, so as to prevent politicization of the issue at hand.

Second, there has to be an element of a repeated game in the matching zone. Hence, the participants must have the expectation that they will have to deal more often with the other actors, in order to induce a cooperative attitude. With some broad-ranging issues, this may be achieved through making the matching zone (semi-) permanent, such as the SER. With project-based matching zones, including the implementation and revision phase in the matching zone can yield a similar effect, since participants can frustrate the execution of the project afterwards if they are not content with the outcome.

Third, one has to strike a subtle balance between the representativeness and efficiency of the matching zone. While including all affected actors individually will lead to a very cumbersome decision-making process, excluding too many parties will on the other hand bring about discontent and a lack of legitimacy. An instrument for striking such a balance is through the use of the "funnel model", as employed in the *orçamento participativo* in Porto Alegre. By narrowing down the number of actors as the participation process progresses, one ensures that agenda-setting is not overly limited, while the discussion of contentious issues and technical details is left up to those who have the time, resources and knowledge.

Fourth, one needs impartial arbitration. This may be done through installing an independent president; a trusted figure who is seen as being "above the parties" and who is gifted with a talent for bringing people together. Another, complementary, way to achieve such arbitration is through the use of "independent experts", such as the independent members in the SER. These may provide the matching zone with the necessary scientific and technical expertise, while often being a highly conciliatory factor in discussions. It is absolutely essential that these arbitrators have no stakes in the issue at hand.

Fifth, there must be clear constraints from the outset of the matching zone. When starting the discussion, the participants should be aware of the allotted funds, the deadlines that need to be met, the criteria to which any solution must adhere, and any other lateral constraints. This will prevent participants from making outlandish demands, while also imposing some structure and discipline on the matching zone. Moreover, it may be beneficial to restrict the number of possible policy options from which participants can choose, as has been done in the Alders Table. This can focus debate and preclude any options that are unfeasible beforehand.

Sixth, reaping the benefits from IC technology is highly conducive to an efficient exchange of information. Although ICT should not distract from the importance of face-to-face contact, the possibilities for information centralization and sharing are very large, lowering substantially the costs of sharing and retrieving such information (cf. Janssen and Gortmaker 2005).

If the design of a matching zone adheres to these principles, and moreover is suited to the specificities of the policy area, the chances of the matching zone becoming a success are strongly enhanced.

2.5.3 *The Operational Level: How to Manage a Matching Zone*

Having the right design is not a guarantee for success: efficient management of the matching zone is essential to its functioning, and is a process that never stops. The gist of the analysis of this chapter is that a cooperative attitude is the most important trait to cultivate in order to keep transaction costs down and optimize outcomes. Three guidelines on management can be distinguished to achieve this:

1. Maintain procedural and outcome fairness
2. Breed an atmosphere of mutual trust and informal contact
3. Hold on to constraints and earlier agreements

First, at all times a sense of fairness should be maintained. Since the execution phase of any project or policy also requires at least some degree of public support, it is paramount that people directly involved be satisfied with both the process and the outcome. Giving all participants some voice in the outcome and preventing excessive social pressure is hence key to achieving *ex post* satisfaction.

Second, fostering an atmosphere of mutual trust and informal contact between the members of the matching zone can help to smoothen bargaining and propagate a cooperative attitude. This effect works both on a psychological level and through the repeated-game argument seen above. If participants are at ease and are better aware of each other's intentions and reasoning, they are more likely to cooperate. Independent experts can be helpful, for instance in their role of chairperson or moderator, to create such atmosphere of ease. Also, if participants are likely to see each other in more venues than just the matching zone, it pays off to behave collaboratively. There is, however, a risk in this: if participants get too close and friendly, there is a chance they become overly cooperative and lose sight of their constituents. This, in turn, puts into jeopardy the legitimacy and long-term functioning of the matching zone. Hence, it is also up to the managers of the matching zone to maintain a professional atmosphere in which participants are expected to be reliable representatives of their constituency.

Third, it is important that the participants are made to honor any *ex ante* constraints placed upon them, as well as any collective agreements they have made earlier. If agreements are not respected, the matching zone may descend into chaos, with trust breaking down easily. Hence, it is up to the (impartial) chairperson to hold participants up to their agreements.

2.6 Conclusion

The modern-day interaction between government and society is rife with unnecessary transaction costs and suboptimal decision-making. This chapter has explored the potential of institutionalizing the setup of consultation and compromise finding with stakeholders to render this interaction more efficient, by lowering transaction costs and optimizing decisions. In these so called matching zones, the government organizes a forum for decision-making between the government and citizens and/or firms. Through a number of cases the chapter demonstrates that matching zones come in many shapes and sizes, but that they all have in common that important political and economic actors are brought together to rationally and cooperatively discuss their different interests. Another common feature of these matching zones is that independent experts, albeit as chairpersons or as moderators, may be helpful in the process of reaching compromise agreements. It is showcased that, in practice, such matching-zone-type institutions may indeed improve upon the *status quo ante*. This has come about through carefully crafted organizational mechanisms, but also through institutional experimentation. Subsequently, the chapter explores a number of theoretical considerations that give backing to the matching zone's potential for efficiency improvement. The main conditions here seem to be hierarchical enforcement of agreements, repeated interaction between parties, and improved transaction fairness.

Although there are no systematic empirical evaluations of matching zones, some broad lessons can be drawn from both practical and theoretical insights. Specifically, the design of a matching zone should try to adhere to a set of strategic, tactical, and operational principles At the *strategic level*, instituting a matching zone is only worth the effort if it adheres to at least one of the following three conditions: *(i)* the government has trouble performing its services toward society satisfactorily, due to a lack of information about societal actors; *(ii)* societal actors have trouble fulfilling their obligations towards the government satisfactorily, due to bad communication with the government, and/or due to a lack of coordination between governmental departments; and *(iii)* representation of important affected parties is inevitable, due to popular demand and/or likely obstruction of implementation by these parties. Moreover, the matching zone should be the most efficient way of alleviating one of these problems.

At the *tactical level*, the design of a matching zone should adhere to the following six principles: *(i)* there should be ample incentives for consensus, or at least for the will to reach compromise agreements; *(ii)* there should be the prospect of long, repeated interaction; *(iii)* the design should strike a balance between representation and efficiency; *(iv)* there must be an impartial arbiter of some sort (the independent expert); *(v)* the constraints should be clear from the onset of the matching zone; and *(vi)* IC technology should be utilized optimally.

At the *operational level*, there are three management principles the chair of the matching zone should adhere to: *(i)* procedural and outcome fairness should be

strived for; *(ii)* an atmosphere of frequent, informal contact and trust should be fostered; and *(iii)* ex ante constraints and agreements made should be respected.

There is still much scope for additional research on the optimal setup of matching zones. Although the four cases discussed in this chapter show how experts may, in different settings, contribute to reach compromise agreements, their role should be studied more closely in order to come to some archetypical function of experts in the matching function. A further road to follow is to combine the experiences with framing in communication and negotiation theory with the lessons from new institutional economics in the design of matching zones (see e.g. Putnam and Holmer 1999; Brummans et al. 2008). Yet, this is exactly what makes the concept of the matching zone so exciting: it allows for institutional innovation, bringing a breath of fresh air to the oft-traditional domain of politics. Although there are likely to be many pitfalls along the way, the key lesson remains that creativity and institutional experimentation can yield surprising new forms of governance. In a world that asks for dynamism, adaptation, and creative competitiveness, such innovations will be ever more borne out of necessity, rather than luxury.

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