The Economics of Public Organizations

Prof. Maitreesh Ghatak

Michaelmas Term, 2008-09

Office Hour:
Michaelmas term: Friday 4-5PM (week 1-5) or by appointment
Lent term: Tuesday 4-5PM or by appointment

In this part of the sequence on Contracts and Organizations, we look at *public organizations*, namely, organizations that are wholly or partly involved with the production of public goods/services (e.g., schools, hospitals). These can be publicly owned, privately owned or a partnership between the two. We discuss how standard results from contract theory have to be modified in these settings, such as how should incentive contracts be designed when performance cannot be measured well, agents are motivated, how to maintain mission integrity in these organizations given that outcome measures are vague, what happens to incentive contracts when these organizations compete, the role of private non-profit firms, whether extrinsic incentives may crowd out intrinsic motivation, and the role of ownership and property rights. There will be five lectures of 2 hours each for this segment of the course.

Syllabus

- Lecture notes will be posted as we go along.
- (JSTOR) means available via JSTOR
- * means required reading

Background Readings

- Akerlof, G. and R. Kranton (2005): "Identity and the Economics of Organizations", Journal of Economic Perspectives, 19(1), Winter. (JSTOR)
- T. Besley and M. Ghatak (2006): "Public Goods and Economic Development" in *Understanding Poverty*, (A. Banerjee, R. Benabou, D. Mookherjee, eds.), Oxford University Press.
- Ellingsen, T. and M. Johannesson (2007): "Paying Respect", Journal of Economic Perspectives, Fall, 21(4).
- Hansmann, H. (1987): "Economic Theories of Nonprofit Organizations" in W. Powell ed. The Nonprofit Sector, Yale University Press.

Topic 1: Incentive Contracts in the Presence of Measurement problems, multi-tasking, multiple principals, & motivated agents

*Dixit, A. (2002), 'Incentives and organisations in the Public Sector: An Interpretative Review', *Journal of Human Resources*, 37, 696-727 (JSTOR)

*Tim Besley and Maitreesh Ghatak (2005): "Competition and Incentives with Motivated Agents" *American Economic Review*, June 95(3).

Burgess, S. and M. Ratto (2004): "The Role of Incentives in the Public Sector: Issues and Evidence" *Oxford Review of Economic Policy*, Vol. 19 (2): Financing and Managing Public Services.

Courty, P. and G. Marschke (1997), 'Measuring Government Performance: Lessons from a Federal Training Program, *American Economic Review*, Papers and Proceedings 87, 383-88 (JSTOR)

Heckman, J., C. Heinrich and J. Smith (1997), 'Assessing the Performance of Performance Standards in Public Bureaucracies', *American Economic Review*, Papers and Proceedings, 87, 383-395 (JSTOR)

Topic 2: What to do when explicit incentives cannot be used much? The Roles of task assignment, hiring, sorting, non-monetary incentives and supervision.

Klaus Schmidt (1997): "Managerial Incentives and Product Market Competition", *Review of Economic Studies*, vol. 64(2), pp 191-213

DEWATRIPONT, M., I. JEWITT, AND J. TIROLE, (2000): "Multitask Agency Problems: Focus and Task Clustering", *European Economic Review*, vol. 44, n. 4-6, May 2000, p. 869-877.

Holmstrom, B. and P. Milgrom (1991): "Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design", Journal of Law, Economics, and Organization.

*Tim Besley and Maitreesh Ghatak (2005): "Competition and Incentives with Motivated Agents" *American Economic Review*, June 95(3).

Tim Besley and Maitreesh Ghatak (2006): "Sorting with Motivated Agents: Implications for School Competition and Teacher Incentives", *Journal of the European Economic Association*, Papers and Proceedings.

McMillan, Robert (2003): "Competition, Incentives, and Public School Productivity", Working Paper, University of Toronto.

Tim Besley and Maitreesh Ghatak (2003): Incentives, Choice and Accountability in the Provision of Public Services, *Oxford Review of Economic Policy*, Vol. 19 (2): Financing and Managing Public Services.

*Prendergast, C. (2008): "Intrinsic Motivation and Incentives." *American Economic Review: Papers and Proceedings*, 2008, *98*(2), pp. 201-05.

Prendergast, C. (2007): "The Motivation and Bias of Bureaucrats." *American Economic Review*, 2007, *97*(1), pp. 180-96.

*Akerlof, G. and R. Kranton (2008): "Identity, Supervision, and Work Groups" *American Economic Review*, Papers and Proceedings, May 95(3).

*Tim Besley and Maitreesh Ghatak (2008): "Status Incentives", *American Economic Review*, Papers and Proceedings, May 95(3).

Topic 3: How to motivate the manager when performance cannot be measured? The cost quality trade-off and the problem of mission integrity

*Besley, T. and M. Ghatak (2006): "Mission Integrity in Public Organizations", (No draft available: see the lecture notes for the slides)

*Glaeser, E. and A. Shelifer (2001): "Not for Profit Entrepreneurs", *Journal of Public Economics*, 2001, 81, 99-115

Francois, P. (2003): "Not-for-profit Provision of Public Services", *Economic Journal*, 2003, 113, C53-61.

Francois, P. (2000): "Public service motivation as an argument for government provision", *Journal of Public Economics*, 2000, 78, 277-299.

*Francois, P. and M. Vlassopoulos (2008): "Pro-social Motivation and the Delivery of Social Services", CESifo Economic Studies, 2008.

*Hansmann, H.B. (1980): “The Role of Nonprofit Enterprise”, *The Yale Law Journal*, 89 (5), April (JSTOR)

Easley, D. and M. O'Hara (1983): "The Economic Role of the Nonprofit Firm," Bell Journal of Economics, The RAND Corporation, vol. 14(2), pages 531-538, Autumn

*Tim Besley and Maitreesh Ghatak (2007): “Retailing Public Goods: The Economics of Corporate Social Responsibility”, *Journal of Public Economics*, Vol. 91, No. 9, p. 1645–1663.

Topic 4: Can explicit incentives crowding out intrinsic motivation?

Engers, M. and J. Gans (1998): “Why referees are not paid (enough)”, American Economic Review, 88(5), 1341-1349. (JSTOR)

*Benabou, R. and J. Tirole (2006): “Incentives and Prosocial Behaviour”, *American Economic Review,* 96(5), December (2006), 1652-1678.

*Benabou, R. and J. Tirole (2003): "Intrinsic and Extrinsic Motivation", *Review of Economic Studies,* 70(3) (2003), 489-520.

Ghosh, S. and A. Karaivanov (2007): “"Can a Raise in Your Wage Make You Worse Off? A Public Goods Perspective”, *Journal of Development Economics*, *84(1), pp. 551-71,*

Francois, P. (2005): “Making a Difference”, Working Paper, University of British Columbia.

Seabright, P. (2002): “Blood, Bribes, and Crowding Out of Altruism by Financial Incentives”, Working Paper, IDEI Toulouse.

Ellingsen, T. and M. Johannesson (2007): “Pride and Prejudice: The Human Side of Incentive Theory”, Forthcoming, AER.

Sliwka, D. (2006): “Trust as a Signal of a Social Norm and the Hidden Costs of Incentive Schemes”, Forthcoming AER.

Topic 5: Who should own public goods? Government vs private ownership, and the role of public-private partnerships

*Tim Besley and Maitreesh Ghatak (2001): "Government versus Private Ownership of Public Goods" *Quarterly Journal of Economics*, Vol. 116, No. 4, p.1343 – 1372.

Tim Besley and Maitreesh Ghatak (1999): Public-Private Partnership for the Provision of Public Goods: Theory and an Application to NGOs, STICERD Working Paper Series, DEDPS 17.

Hart, Oliver, Andrei Shleifer, and Robert Vishny (1997): "The Proper Scope of Government: Theory and an Application to Prisons," *Quarterly Journal of Economics*, CXII (1997), 1119–1158 (JSTOR)

*Hart, O. (2003): "Incomplete Contracts and Public Ownership: Remarks, and an Application to Public-Private Partnerships", *Economic Journal*, 113.

Bennett, J. and E. Iossa (2006) "Building and managing facilities for public services", *Journal of Public Economics* 90 (2006) 2143–2160.

Martimort, D. and J. Pouyet (2006) "Build It or Not: Normative and Positive Theories of Private-Public Partnerships" Working Paper, IDEI, Toulouse.