Motivation, incentives and performance in the public sector

Pierre Garrouste and Anne Yvrande-Billon

Syllabus
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The common view in economics has long been that monetary incentives enhance effort but different explanations have recently been pointed out both in economics and psychology. In addition, with the waves of reforms aimed at increasing the efficiency of the public sector and measuring its performance (see for instance the RGPP in France), the issue of motivations and incentives of public agents has become crucial and is now largely dealt with in the literature.
In this course, we present the growing theoretical and empirical literature that investigates the relationships between motivation, incentives and effort in the public sector. Accordingly, this course attempts to present the main characteristics of the public sector (that is its specificity as compared with the private sector), and the difficulties to manage it in an efficient way. Various examples of reforms of public sectors activities (e.g. school, health care, prisons, police…) are studied.

Class 1: Incentives and performance: Basics

We briefly come back on the main results of the incentive theory regarding the relationship between (monetary/extrinsic) incentives and effort. Results of original empirical studies on this issue allow us to illustrate the way the *homo economicus* traditionally reacts according to this literature.

Readings:

*Holmstrom B., & Milgrom, P. (1991), "Multi-task Principal–Agent Analyzes: Incentive contracts, Asset Ownership and Job Design", *Journal of Law, Economics and Organization*, 7, 24-52.

*Holmström, B., & Milgrom, P. (1994). The firm as an incentive system. *American Economic Review*, 84, 972–991.

*Lazear, E. (2000), "Performance Pay and Productivity", *American Economic Review*, 90, 1346-1361

Class 2: The main specificities of the public sector

To see how the general theory of incentives sketched in the previous course relates to the practice in the public sector, it is useful to present some broad features of government agencies and bureaucracies, and observe how they differ from firms and other organizations in the private sector of the economy for which the theory was initially developed. For instance, the fact that the output of public activities is not sold on the market or is not sold at its real price is the distinctive feature of what is commonly referred as the 'non market sector'. Consequently, the basic solution was, until recently, to evaluate the public sector production on the basis of the following equation: *input* = *output*. The corollary was the impossibility to measure the productivity of the public sector.

Readings:

*Acemoglu, D., Kremer, M., Mian, A. (2007) "Incentives in Markets, Firms, and Governments", *Journal of Law, Economics and Organization.*

*Dixit, A. (2002) "Incentives and Organizations in the Public Sector: An Interpretative Review", *Journal of Human Resources,* 37(4), 696-727.

*Tirole, J. (1994) « The Internal Organization of Government », *Oxford Economic Papers,* 46, 1-29

*Charreaux, G. (1997) "L'entreprise publique est-elle nécessairement moins efficace ?", *Revue Française de Gestion,* Octobre, 38-56.

*Laffont, J.-J. (2000) « Etapes vers un Etat moderne : une analyse économique », in *Etat et Gestion Publique,* Rapport Conseil d'Analyse Economique n°24, Paris, La Documentation Française,.

Class 3: Measuring the government output

A major obstacle to the introduction of performance related measures in the public sector is the difficulty to measure government output as the objective function of public agencies and bureaucracies is multidimensional. In this course we present the nine Atkinson's principles that are supposed to frame the way the performance of the public sector could be measured. We present the results of the main important reports that try to explore the relationship between the characteristics of the public sector and the possibilities to measure its performance

Readings:

*Atkinson, T. (2005) *Atkinson Review: Final Report, Measurement of Government Output and Productivity for the National Accounts,* London, Palgrave McMillan.

Class 4: The specific motivations of public agents

The public administration science conception of the relationships between motivation, incentives and performance in the public sector is usually based on the idea that individuals who work in the public sector have some specific characteristics. Thus, it is argued that preferences and work motivation of public sector employees differ from those of private sector employees. For instance, individuals working in the public sector are assumed to have more pro-social inclinations (that is to be more altruistic) and to be more risk-averse than employees of the private sector. In this course, we present the main characteristics of public agents identified in the literature.

Readings:

*Buelens, M. & Van den Broeck, H. (2007). "An Analysis of Differences in Work Motivation between Public and Private Sector Organizations", *Public Administration Review*, 65-74

*Perry, J. L., Mesh, D., & Paarlberg L. (2006) "Motivating Employees in a New Governance Era: The Performance Paradigm Revisited", *Public Administration Review*, 66(4): 505-514

*Wright, B. E. (2007) "Public Service and Motivation: Does Mission Matter? *Public Administration Review*, 54-64

Class 5: Formalizing intrinsic motivations

This course is dedicated to the presentation of seminal papers where the incentive theory framework is extended to include intrinsic motivations or pro-social behaviors of individuals. We present some pieces of literature that challenge the traditional vision of the relationships between incentives and motivation and stress the notion of *crowding out* effect. An experimental game will be played with participants to the seminar.

Readings:

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

*Bénabou, R. & Tirole, J. (2006) "Incentives and Prosocial Behavior", *American Economic Review*, 96(5), 1652–1678

*Besley, M. & Ghatak (2005) "Competition and incentives with motivated agents" *American Economic Review.*

*Auriol, E. & Brilon, S. (2009) "The Good, the Bad and the Lazy: Labor Management in Non-profit organizations", *WP IDEI*.

Classes 6 & 7: Some experiences of performance related pay in the public sector

High-powered incentive schemes are designed to align behavior of agents with the interests of the principal implementing the system. But a shortcoming of such schemes, particularly in the public sector, is that they are likely to induce behavior distortions. Recent empirical researches have indeed indicated that public sector (and nonprofit) organizations are responsive to performance measurement and performance related pay (i.e. extrinsinc motivations) in both productive and unproductive ways. In these two courses (C6 and C7), we present examples of reforms of the public sector and insist on the effects of the new management and incentive schemes on individuals' behavior and performance.

Readings:

*Jacob B.A., Levitt S. (2003) "Rotten Apples: An investigation of the Prevalence and Predictors of Teacher Cheating", Quarterly Journal of Economics, 843-877.

*Dowling, B., and Richardson, R. (1997). "Evaluating Performance Related Pay for Managers in the National Health Service", *The International Journal of Human Resource Management*, 8(3): 348-366.

*Franck, R. G., Rosenthal M. B. (2006) "What Is the Empirical Basis for Paying for Quality in Health Care?" *Medical Care Research and Review*, 63(2): 135-157.

*Behagel, L., Crepon, B., Guitard, J., Gurgand, M., & Le Barbanchon, T., (2009) "Counceling the unemployed in France", *Working Paper Crest*.

Class 8: The provision of public services: the make-or-buy trade-off

Governments can provide services with their own employees or by contracting with private or public sector providers. We present two models of this "make-or-buy" choice that highlight the trade-off between productive efficiency and the costs of contract administration. The propositions derived from these models are then tested. One model is applied to the service provision choices by U.S. cities (water services, refusal collection, police, etc.). The second model is applied to prisons.

Readings:

*Levin, J., Tadelis, S. (2009) "Contracting for Government Services: Theory and Evidence from U.S. Cities", *Journal of Industrial Economics*, forthcoming.

*Hart, O., Shleifer, A., Vishny, R. (1997) "The Proper Scope of Government: Theory and Application to Prisons", *Quarterly Journal of Economics*, 112, 1127-1161.

Class 9: Corruption and favoritism

In this course, we investigate the determinants of corruption of public agencies with a special focus on public procurement.

Readings:

*Ades, A., Di Tella, R., 1999. Rents, competition and corruption. *American Economic Review* 89 (4), 982–993.

*Burguet, R., Che, Y., 2004. Competitive procurement with corruption. *RAND Journal of Economics* 35, 50–68.

*Celentani, M., Ganunza, J., 2002. Competition and corruption in procurement. *European Economic Review* 46 (7), 1273–1303.

*Compte, O., Lambert-Mogilianski, A., Verdier, T., 2005. Corruption and competition in procurement auctions. *RAND Journal of Economics* 36 (1), 1–15.