

Government 1521  
Bureaucratic Politics:  
Government, Military,  
Social and Economic Organizations

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Lecture 05: Contractual Theories of  
Bureaucracy and Organization

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Outline

1. TC and TC calculus -- *ex ante* and *ex post* costs.
2. insts as constraints & their types
3. ORGS as nexus of contracts
4. theory of inst/org change
  - a) driven by entrepreneurs
  - b) incremental, not revolutionary
5. Asset specificity

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TRANSACTION-COST  
POLITICAL ANALYSIS

1. The Definition: ***Institutions are rules, and organizations are aggregations of rules (nexus of contracts).***
  - "Humanly devised constraints on action."
  - "Rules of the game."
2. Why do they exist? They ***reduce uncertainty*** surrounding political, economic, social transactions.
3. **Transactions Costs (TCs) = uncertainty costs**

<b>ex ante</b>	<b>ex post</b>
(1) measurement	(1) monitoring
(2) specification	(2) enforcement

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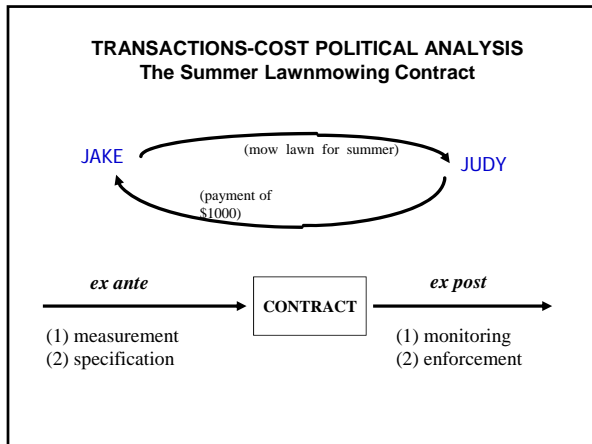
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**TRANSACTION-COST  
POLITICAL ANALYSIS**

4. Problems: TCs lead to payment of *risk premium*, up-front payment to guard against losses.

- foregone transactions -- even though profitable
- moral hazard -- information asymmetry or opportunism ("take \$ and run") creates perverse incentives and kills contracting
- adverse selection -- best person doesn't show

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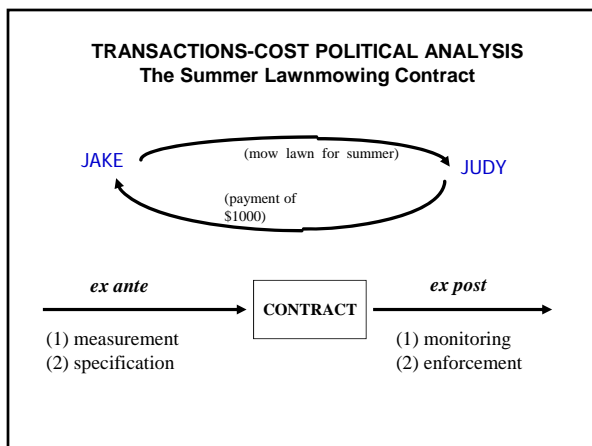
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## INSTITUTIONS AS SOLUTIONS TO TRANSACTIONS COST DILEMMAS

Institutions -- "rules of the game" -- permit otherwise foregone transactions to take place. Create an environment of stable expectations and beliefs.

**Constraints** → ↓ **Uncertainty** → ↓ **Risk Premium**

### Caveats:

Institutions not necessarily efficient.

Institutions ≠ organizations in this theory.

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## INSTITUTIONS AS SOLUTIONS TO TRANSACTIONS COST DILEMMAS

*1. Incremental, not discontinuous or revolutionary.*

2. Stability: Institutional Change "locked in" through actions of organizations created by change. Organizational Change locked-in by institutions and rules created.

- civil service unions and reform
- interest groups, caucuses and seniority
- interest groups and regulatory agencies
- committees and restrictive amendment procedures

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## ORGS as CONTRACTS

1. Think of a Weberian hierarchy as a **tree of contracts**, each one like the lawn mowing contract.
2. What makes things different from the lawn mowing contract is that there are formal positions (recall Simon's adage: if organization is inessential, if all we need is the man, then why do we insist on creating a position for the man?)
3. Beyond these contracts, however, no identity in the organization unless the models are considerably enriched.

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## Williamson and Asset Specificity

Caveat: Jake-Judy contracting problems may not be as bad in repeated (“recurrent”) environment.

But other problems may arise: “First-Mover Advantage”

Williamson’s more general concept: asset specificity.

[site-specific, physical, or human]

“Human assets can thus be described in terms of (1) the degree to which they are firm-specific, and (2) the ease with which productivity can be metered.” [1981: 564]

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Williamson’s schema

Specificity of “Human Assets”  
general                      specific

	easy	Spot Contracting	Obligational Market
MONITORING			
	difficult	Primitive Team	Relational Team [BUREAU?]

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### Example:

#### Making versus Buying Policy and Rules

Why can’t every single federal rule (aspect of federal policy) be written up by Congress and the President?

If “make within,” then Congress uses its own committee system, and White House uses OMB/EOP.

If “buy” then use federal agencies that implement the policy and have knowledge.

OR, more recently, think tanks, interest groups, universities, etc.

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