

A Theory of Authority

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Introduction: Motivation

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- | Legitimacy matters for two reasons.
 1. Agents motivated by sense of duty to follow rules/orders when they are seen as legitimate.
 2. Agents are also motivated to punish and/or report violations.
- | The need for legitimacy serves as a constraint.
- | This paper: explores the implications of such constraints.

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- | Peele's orders seen as illegitimate; faces resistance.
- | Firm's solution: delegate less to Peele, have central office set more rules.
- | Cost to the firm: greater bureaucracy.

Introduction: Related Literature

- | **Persuasion:** Prendergast and Stole (1996); Hermalin (1998); Majumdar and Mukand (2004); Van Den Steen (2009).
- | **Limits to Authority:** Shapiro and Stiglitz (1984); Wernerfelt (1997); Marino, Matsusaka, and Zbojnik (2009); Van Den Steen (2010).
- | **Low-powered versus high-powered incentives:** Holmstrom and Milgrom (1991).

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 1. High-powered: $w(q)$.

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- | $D(q)$: cost of disobedience.
- | We assume the order is considered legitimate only when $q \leq L$, where L parameterizes the principal's legitimacy.

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- | We assume the order is considered legitimate only when $q \leq L$, where L parameterizes the principal's legitimacy.
- | Disobedience is only costly when the order is legitimate:
$$D(q) = \begin{cases} \infty, & q \leq L \\ 0, & q > L \end{cases} .$$
- | Agent has outside option that yields payo of 0.

A Simple Model

Authority Maintenance: $q \leq L$.

The Principal's Problem

- | Maximize p subject to:
 - | (PC), (IC-authority), (AM)

OR

A Simple Model

Solution to Principal's Problem:

1. L high:

- | $q = a_1^{FB}$.
- | low-powered incentives: $w(h) = w(l)$.

2. L intermediate:

- | $q = L$.
- | low-powered incentives: $w(h) = w(l)$.

3. L low:

- | eschew authority.
- | high-powered incentives: $w(h) > w(l)$.

Bolstering Authority

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- | That is, he chooses how much to bolster (b).

Bolstering Authority

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Solution to Principal's Problem:

1. L_0 high:

- | maintain authority/low-powered incentives.
- | no bolstering ($b = 0$).

2. L_0 intermediate:

- | maintain authority/low-powered incentives.
- | bolster ($b > 0$).

3. L_0 low:

- | eschew authority/high-powered incentives.
- | no bolstering ($b = 0$).

Applications

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1. Who is the receiver of orders?

- | Suppose agent A is a better worker than agent B but agent B considers the principal's authority more legitimate.
- | One might hire B rather than A (a costly action taken to bolster authority).
- | Examples: dislike of "overqualified" workers (Bewley); family firms.

Applications

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- | Suppose the principal has more (less) authority over workers than a supervisor.
- | This might lead to under-delegation (over-delegation).
- | Examples: Gouldner's Gypsum Company (under-delegation); Ostrom on detrimental effects of forest nationalization (over-delegation).

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- | Example: problems associated with merging firms with different cultures (see Buono, Bowditch, and Lewis (1985)).

4. An Alternative Explanation for Efficiency Wages

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- | Suppose paying a higher expected wage increases the principal's legitimacy ($L = L_0 + E(w)$).
- | It may be optimal to pay an efficiency wage: that is, set a wage for which (PC) is non-binding.

Concluding remarks

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- | The paper raises several important questions.
- | To what extent are persistent performance differences across firms (PPDs) explained by differences in authority?
- | Relatedly, is variance in firms' management practices due to differences in managerial skill or authority?
- | Is lack of legitimate authority an important reason for underdevelopment (see Basu (2015))?