Economic behavior within organizations
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STEPHEN A. HOENACK

University of Minnesota

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Preface

This book is an attempt to extend economic theory to the resource allocation choices that are made within a firm or other organization. A number of criteria guided my work. One was that an economic theory of organizations should not depend on restrictive assumptions that employees desire to maximize particular variables such as sales or budgets. Another criterion was that an organization's supplies of its outputs should be derivable from the supply behavior of its individual employees. I also wanted the theory to take account of the investments that employees make in their jobs and to yield implications from this behavior for the organization's internal structure and growth.

My main purpose, however, was to see whether economic theory could provide a wide-ranging set of hypotheses about issues of interest to economists and organization theorists. For example, could economic theory provide hypotheses about the implicit prices that employees attach to resources, employees' supplies of their contributions to outputs, and their demands for information about production possibilities? Could it provide hypotheses about the formal and informal mechanisms by which employees coordinate their activities? Although this book's analysis is only a beginning, I am convinced that economics is a useful tool for analyzing both types of issues. I have also concluded that when economic analysis and organization theory deal with the same issues, their results do not generally conflict. Although economic analysis has a different role in focusing on employees' choices in allocating resources, it does not emerge as a competing approach to organizations, and the many quotations in this book from the literature on organizations suggest that it is often complementary. I predict that further advances in our understanding of organizations will require economists to make use of insights provided by organization theorists and vice versa.

Many conclusions about economic activity within an organization can be derived from the cost advantages that particular employees have about production possibilities and about quantities, characteristics, and uses of inputs and outputs. These information cost advan-
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tages are derived from the production functions for an organization’s outputs in Chapter 2, where they are shown to lead employers to delegate discretion over resource allocation to employees. Employees can take advantage of this discretion to pursue their own objectives at their employers’ expense. Chapter 3 analyzes how employers impose constraints on employees to limit their costs of employees’ contributions to output. Once these constraints are in place, the organization’s resource allocation can be analyzed in short- and long-run periods. Chapters 4 through 6 present the analysis of the short run; Chapters 7 through 9, the analysis of the long run.

In the analysis of the short run, I first consider in Chapter 4 the economic behavior of individual employees under the artificial assumption that there are no technological spillovers among different employees’ productive activities. This assumption is then relaxed, and the implications of such spillovers are explored. Subsequently in Chapter 5, I derive hypotheses about the short-run supply behavior of private corporations and private nonprofit organizations from the supply behavior of their individual employees. After presenting an analysis of the economic behavior of individual legislators and of legislatures as organizations, Chapter 6 analyzes the short-run supply behavior of public organizations.

In the long run, employees’ investments to increase their well-being within the organization come to fruition. For example, employees establish means of coordinating their activities in order to reduce the effectiveness of the constraints imposed on them. Chapter 7 explores these investments and analyzes their effects on employees’ supply behavior. This chapter provides an analysis of employers’ choices in using and delegating authority and contrasts cases where authority and voluntary arrangements are used to coordinate employees’ actions. Chapters 8 and 9 analyze the effects of employees’ investments on long-run resource allocation in two separate contexts. In Chapter 8, I assume that the organization continues to produce the same outputs and cannot change its status from being, for example, a private corporation, to being a public organization. In Chapter 9 it is assumed that an organization can produce different outputs and might be able to change its status, and the roles of employees in making these changes are analyzed. For example, employees’ roles in mergers and acquisitions of private corporations and in a legislature’s establishment of public organizations are considered.
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Chapter 1 presents an overview of the main concepts of the theory, and Chapter 10 summarizes some of the hypotheses presented. Separate summaries of hypotheses are presented after most of the major sections within Chapters 4 through 9. Definitions of core terms are presented in Chapter 1. These terms are again described with their first use in the subsequent chapters and are also defined in a glossary at the end of the book.

The following individuals made valuable comments on an early draft of the manuscript: David J. Berg, Edward M. Foster, T. Paul Schultz, Donald S. Watson, and William C. Weiler. Leonid Hurwicz’s comments on the manuscript were especially helpful, and his enthusiasm about the project was very encouraging in the early stages when the work seemed most difficult. Douglas C. Dacy and Vernon W. Ruttan also provided invaluable criticism and encouragement. Robert T. Kudrle’s insightful reviews of two separate drafts of the manuscript resulted in many important improvements in the theory. Thomas P. Chester made substantial contributions to Chapter 6 and a section of Chapter 3 by pointing out several errors. An anonymous reviewer’s extremely helpful suggestions became a blueprint for one major revision of the manuscript.

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My wife, Margaret Dougherty Hoenack, to whom this book is dedicated, convinced me that an economic analysis of organizations
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could lend insight into a number of issues that have largely concerned organization theorists. But, most important, our life together has given me a state of mind in which projects like this seem more achievable.

S.A.H.

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