Pro-social Motivation & Incentives

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(Drawing on joint work with Tim Besley)

Introduction

- The narrow self-interest driven view of individuals in the economic domain has increasingly come under question

- Recent work in economics has moved beyond stylized models of motivation based on a narrow view of *homo economicus* who cares about only money and leisure, and have embraced a wider perspective on motivation.

- Broadly speaking, this has been focused on different approaches to pro-social motivation, such as:
  - commitment to a mission
  - the role of identity
  - commitment to "in-group" (e.g., family, community, tribe)
  - intrinsic motivation
  - reputational concerns & social norms
  - status rewards
  - pure altruism.

- Relatedly, another trend is questioning the division of economic activitiy between the markets and the government

- The traditional belief that markets are the most efficient way of producing private goods, while the government takes care of public goods and services while also correcting a range of market failures is no longer tenable

- Several reasons
  - First, a large body of evidence on market failure where private gains lead to social loss (e.g., bailout of banks during the financial crisis) beyond what was already known (e.g., environmental pollution, lobbying by private corporations)
  - Second, a large body of evidence has accumulated on government failure due, for example, to corruption, waste, absenteeism, and poor quality of service.
  - Third, an increasing importance of private social-sector organizations such as non-profits, NGOs, and social enterprises as well as hybrid organizational forms such as public-private partnerships, and contracting-out, make it too restrictive to equate the provision of public goods and services with provision through government agencies.

- In this talk I will try to give a conceptual overview of the points of departure from standard economic models

- As an application, talk briefly about role of incentives when individuals have pro-social motivation

Part 1: Recent points of departure from standard economic models

The Original Dilemma of Economists?

> "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages." Adam Smith (*The Wealth of Nations*, 1776)

"How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it. Of this kind is pity or compassion, the emotion we feel for the misery of others, when we either see it, or are made to conceive it in a very lively manner. That we often derive sorrow from the sorrows of others, is a matter of fact too obvious to require any instances to prove it; for this sentiment, like all the other original passions of human nature, is by no means confined to the virtuous or the humane, though they perhaps may feel it with the most exquisite sensibility. The greatest ruffian, the most hardened violator of the laws of society, is not altogether without it."
Adam Smith (*The Theory of Moral Sentiments*, 1759)

The Two Mr. Smiths

Economists have adopted a simplifying strategy that goes back at least to John Stuart Mill (1867)

> "[Political economy] does not treat of the whole of man's nature . . . it is concerned with him solely as a being who desires to possess wealth, . . . it predicts only such . . . phenomena . . . as take place in consequence of the pursuit of wealth. It makes entire abstraction of every other human passion or motive."

The Three Separation Assumptions

I will argue that this strategy involves three separation assumptions

- Separation between markets and the government
- Separation between (consumer/donor) preferences & productive activity
- Separation between intrinsic and extrinsic motivation

A. Markets and the Government

- The invisible hand of the market, described in Adam Smith, harnesses consumers' and corporations' pursuit of self-interest to the pursuit of efficiency.

- The state corrects market failures whenever externalities stand in the way of efficiency, and redistributes income and wealth, as the income and wealth distribution generated by markets has no reason to fit society's moral standards.

- Markets are the most efficient way of producing private goods

- Not for Public goods (or bads) where appropriate tax/subsidy or direct provision by the government is warranted

- Also, tax and redistribution to tackle inequality

- Welfare Economics: separation between efficiency role of markets, and distributional concerns

- Assumes no externalities - this is where government's role is acknowledged (Pigou, Lindahl, Samuelson)

B. Consumption and Productive Activity

- Individuals maximize utility as investors, consumers or workers to decide how much to sell, buy, where to work, invest etc

- Firms maximize profits independent of the preferences of the people involved

- Otherwise, competitive markets will push them out

- Business is business, and that does not mix with pleasure or ideals

- You may be a bleeding altruist in your social life, but in your economic life you are ruthless maximizer

C. Intrinsic and Extrinsic Motivation

- Individuals have preferences over various occupations, effort levels (as workers), goods and services (as consumers), investment opportunities (as investors)

- For example, a worker may have a lower cost of effort when he is working in a task he likes - intrinsic motivation

- Money (wages, prices, returns) also affects the choice of individuals to work, buy, or invest

- These can be treated separately - if someone pays you to do something you like to do anyway, then you do it even more

Over the last few decades economists have been exploring relaxing these three sets of separation assumptions

1. Relaxing the Separation between Markets and the Government

- The traditional view equated public goods to government provision

- Benevolent government steps in, and uses

  – corrective taxes/subsidies

  – regulation

  – direct provision

- This view ignored
  - government failure (agency, political economy etc)
  - role of non-state non-market institutions such as voluntary organizations (non-profits, NGOs)
  - social enterprise

2. Relaxing the Separation between Consumption & Production

- Production efficiency not guaranteed if there are market frictions

- Agency problems, information and transactions costs

- Incentives matter, organizational form matters (non-profits, social enterprise, for-profits etc)

- Organizational form may reflect the preferences of workers, owners through self-selection or signalling or commitment to certain missions

- Motivation can be a substitute for incentive pay (Besley-Ghatak, 2005)

3. Relaxing the Separation between Intrinsic and Extrinsic Motivation

- Using monetary incentives may crowd out intrinsic motivation

- Richard Titmuss (1971) found that the US where blood-donors are paid had lower quality blood supplied than UK where it was based on voluntary donation

- Recent books by Michael Sandel, Debra Satz
  - What Money Cannot Buy
  - Why Some Things Should Not be For Sale

- Subsequent experiments (surveyed by Frey and Jergen, 2000 and Fehr and Gachter, 2001) provides evidence for crowding out of intrinsic motivation if monetary incentives are provided.

- Nava will talk about her more recent work with Oriana on this

Part 2 : Role of incentives when individuals have pro-social motivation

- In my recent theoretical work with Tim Besley, have explored the role of how financial incentives (performance pay) interact with pro-social motivation

- The general conclusion we derive is motivated agents receive lower pay as well as performance bonus than unmotivated agents and yet are at least as productive

- Incentives and motivation are substitutes

- This means that, without taking into account selection of workers in terms of their motivation, one could erroneously conclude that incentive in the provision of goods with social returns provided by agents with pro-social motivation, will simply lower pay without an attendant effect on effort.

- Having a workforce which is committed to a pro-social cause may have beneficial consequences, suggesting a focus on worker formation beyond notions of human capital based on skills

- However, this causes motivated agents to have to pay a performance-pay penalty, causing a selection problem

- This reflects the trade-off between hiring agents with pro-social motivation and incentive pay with hiring a more pro-social agent leading to lower bonus pay.

- The selection problem is likely to be stronger when alternative employment opportunities are poorer (e.g., in developing countries where jobs are more scarce)

- As alternative employment opportunities improve, the selection problem becomes easier to solve which suggests that the expected quality of public service provision will be higher as labour marker options improve, which is consistent with empirical evidence (Finan, Olken, Pande, 2017).

Concluding Remarks

- There is now a large and growing empirical literature which looks at the impact of incentives on performance in areas where pro-social motivation is deemed to be relevant.

- Moreover, there have been increasing efforts to explore these issues in field experiments such as Ashraf, Bandiera and Jack (2014), Deserranno (2017), Mullaridharan and Sundararaman (2009) and Rasul and Rogger (2013) (see Finan et al, 2017 for a review).

- If intrinsic motivation is important then the challenge is to understand
  - How to "unlock" it or create it
  - What organizational and contractual forms make the best use of it