

Organizational economics: applications to metropolitan governance

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Abstract: This comment relates to Richard Posner (2010), the lead article for this issue. Posner applies ‘the principles of organization economics’ to the study of diverse types of organizations. His study comparing the FBI to other types of police organization is important and compatible with the study of urban policing in American metropolitan areas. Many policy prescriptions are based on an inadequate understanding of the diversity of urban public good production functions and a lumping together of every type of police service. A brief review of research related to the concept of polycentricity as related to urban services in metropolitan areas is provided as a way of further illustrating Posner’s concern that finer distinctions need to be made in the way scholars analyze organizational economics.

1. Introduction

In the lead article for this issue, Richard Posner (2010) applies the ‘principles of organization economics’ to the study of publicly held business corporations, the US intelligence ‘community’, the Federal Bureau of Investigation, and the judiciary in common law and civil law nations. He analyzes how the concept of agency costs as well as the challenge of matching incentives to performance of particular activities help to explain some of the perversities found in these organizations. In particular, Posner is concerned with (1) the excessive compensation allocated to the top bureaucrats in publicly held private corporations, (2) the uniform incentives that reduce the performance of the FBI in regard to intelligence responsibilities in contrast to criminal investigation duties, and (3) the methodologically conservative and unadventurous civil-law judiciary as contrasted to the common-law judiciary.

Posner makes an interesting comparison between the internal incentives of a police organization such as the FBI related to two different services – criminal investigation versus international security. He astutely points out that the basic incentives and structure of organization in a bureaucratic agency such as the FBI are better attuned to the job of criminal investigation than they are to the much more subtle and difficult task of security. His keen analysis of the diverse services

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in policing, and consequently the different production functions and incentives, is congruent with findings from studies of public agencies in metropolitan areas, especially police and education.

Instead of recognizing the diverse production functions involved in the production of urban services, many policy analysts have inappropriately assumed that all urban public services have similar production functions that are all characterized by substantial economies of scale. I agree with Posner that one has to look at the specific service involved rather than generalize for all services assigned the same name in everyday parlance. In our empirical studies of the police industry in metropolitan America, we found immense differences in the incentives facing police, given differently structured enterprises (see McGinnis, 1999: chapters 7–10).

2. On polycentricity

Scholars have leveled massive criticism at metropolitan areas across the United States and Europe due to the large number of small-, medium-, and large-scale governmental units operating at the same time (see, for example, Berry, 2008). Scholars think this is chaotic. Vincent Ostrom, Charles Tiebout, and Robert Warren wrote a classic article in 1961 entitled ‘The organization of government in metropolitan areas: a theoretical inquiry’. The authors were trying to make scholars aware that a simple dichotomy between ‘the’ market and ‘the’ government was not a good scientific approach to the study of public economies. Further, ‘the’ market is usually composed of many small-, medium-, and large-scale firms, and the expected efficiency of a market disappears if it is consolidated into a monopoly.

Even though one cannot apply *all* lessons derived from the analysis of market economies to the public sector, economics provides strong findings regarding the dangers of allocating all production activities for a good or service to a single unit. Drawing on the evidence of public sector development in the United States, V. Ostrom and colleagues urged scholars and policy analysts to think of the public sector as a polycentric *system* rather than a monocentric *hierarchy*. In a later essay, V. Ostrom (1999: 57) defined a polycentric order as ‘one where many elements are capable of making mutual adjustments for ordering their relationships with one another within a general system of rules where each element acts with independence of other elements’.

3. Research on polycentric policing

The early theoretical work on polycentricity stimulated three decades of intense research on the organization and performance of police agencies (E. Ostrom,

2007). The efficiency of any particular police organization depends on the structure of the full police services industry serving a metropolitan area as well as the internal structure of a particular police department. Services that are generated in direct interaction with citizens – such as patrol and criminal investigation – must involve citizens as essential coproducers of the service. Coproduced services tend to be provided most effectively by small- to medium-sized departments that stress learning about the differences among neighborhoods and building strong relationships with citizens.

This can be contrasted to the production of criminal laboratory services that require highly specialized equipment, training, and do involve substantial economies of scale. Those recommending consolidation of police serving metropolitan areas frequently assert that it is inefficient for small police departments to do their own criminal laboratory analysis. This is indeed the case! Most police agencies, however, have figured this out. In a study of 80 metropolitan areas across the United States, the police agencies in most metropolitan areas have negotiated arrangements with one or two enterprises to produce crime laboratory services (E. Ostrom and Parks, 1999). In many cases, the producers of these services are hospitals located in the metropolitan area that have already installed the needed equipment to perform the relevant blood tests that are an integral part of laboratory services.

In order to examine the effect of interorganizational arrangements on police performance, we relied on measures of performance, such as the allocation of police personnel to on-the-street assignments and the relative efficiency of agencies in producing response capacity and solving crime (E. Ostrom, 2007). For each of the 80 metropolitan areas, we calculated the number of producers of each type of service (multiplicity) and the proportion of the population being served by the largest producer of each type of service (dominance). Metropolitan areas with low scores in regard to multiplicity and high scores in regard to dominance come closest to approximating the ‘consolidated’ model. Metropolitan areas with high scores in regard to multiplicity and low scores in regard to dominance come closest to approximating the ‘fragmented’ metropolitan area so strongly criticized in the policy literature.

We found a distinct difference in the availability of sworn officers to conduct patrol in the metropolitan areas, depending upon the structure of interorganizational arrangements. While *more* officers per capita were employed in the most consolidated metropolitan areas, a lower percentage of these officers was actually assigned to patrol divisions in these areas (E. Ostrom *et al.*, 1999). One-third more officers were required in the most consolidated metropolitan areas to place the *same* number of officers on patrol as compared to the least consolidated metropolitan areas. Citizens living in the most fragmented metropolitan areas received more police presence on the streets for their tax expenditures than did citizens living in the most consolidated areas (Parks, 1985).

4. Research on polycentric education

Related analyses can be made on the consolidation of school districts. The presumption that there are very substantial economies of scale related to K-12 education is again grossly overexaggerated and applied uniformly to all aspects of producing education. In terms of how students can enhance their own learning abilities over the long run, coproduction is again very important. Students are not just idle boxes sitting in a factory line being filled with screws and other components that make them think and produce creatively in the long run. The factory image is an entirely inappropriate analogy for education. If students do not actively coproduce their learning in the classroom and at home, they cannot learn.

Other research has been undertaken since the early police studies that strongly supports the findings of these earlier studies. Scholars have conducted rigorous empirical research that has challenged the presumptions that larger public school districts achieve higher performance (Hanushek, 1986; Teske *et al.*, 1993), that fragmentation of governments leads to higher costs (Dilorenzo, 1983; Schneider, 1986; Boyne, 1992), and have provided further insights into the way local governments are constituted (Oakerson and Parks, 1989; Stephens and Wikstrom, 2000). As a result of extensive empirical and theoretical research, the presumed self-evident truth that constructing one government for each metropolitan area is the best way to achieve efficiency and equity, has slowly been replaced with a recognition that judging ‘structure directly on the single criterion of uniformity contributes little to the advancement of research or reform’ (Oakerson, 1999: 117).

5. Polycentric core principles

Instead of a single best design that would have to cope with the wide variety of problems faced in different localities, a polycentric theory generates core principles that can be used in the design of effective local institutions when used by informed and interested citizens and public officials. In his conclusion to an in-depth study of the adverse effects of urban consolidation efforts in the United States and Canada during the last century, Andrew Sancton (2000: 167) reflected:

Municipalities are more than just providers of services. They are the democratic mechanisms through which territorially based communities of people govern themselves at a local level ... Those who would force municipalities to amalgamate with each other invariably claim that their motive is to make municipalities stronger. Such an approach – however well-intentioned – erodes the foundations of our liberal democracies because it undermines the notion that there can be forms of self-government that exist outside the institutions of the central government.

Thus scholars, public officials, and citizens, who are concerned with solving collective-action problems effectively, equitably, and efficiently, recognize the importance of authorizing citizens to constitute their own local jurisdictions and associations using the knowledge and experience they have concerning the public problems they face.

In addition to findings about policing and education, it is also useful to review the basic assumptions of a polycentric approach as applied to the study of metropolitan areas. These are:

1. Public goods and services differ substantially in regard to their production functions and their scale of effects.
2. Policy preferences tend to be more homogeneous within smaller units than across an entire metropolitan area.
3. Citizens who live in areas served by multiple jurisdictions learn more about the performance of any one jurisdiction by seeing or hearing about how problems are handled in other jurisdictions.
4. The presence of large numbers of potential producers of urban goods and services in a metropolitan area allows elected officials more effective choice of producers.
5. Multiple jurisdictions with different scopes and scales of organization allow citizens and officials more choice in selecting modes of providing and producing public goods to try to utilize the best available technology, to achieve economies and avoid diseconomies of scale, and improve performance over time.
6. Producers who must compete for contracts are more likely to search for innovative technologies, to encourage effective team production, as well as citizen coproduction, so as to enhance their own performance (V. Ostrom, 2008a, 2008b; E. Ostrom *et al.*, 1978).

Polycentric metropolitan regions tend to reduce opportunistic behavior even though no institutional arrangement can totally eliminate opportunism with respect to the provision and production of collective goods. Allowing citizens to form smaller-scale collective consumption units encourages face-to-face discussion and the achievement of common understanding. Creating larger collective consumption units reduces the strategic behavior of the wealthy who try to escape to tax havens where they could free ride on the tax contributions of citizens in other jurisdictions. Larger units also can more effectively cope with urban goods and services that have large-scale effects and real economies of scale.

A strong emphasis on organizational economics is important for understanding excessive compensation for executives, the incentives faced by the FBI, and by courts serving roman law and common law legal systems as well as the incentives and performance of diversely structured urban public agencies.

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