Journal of Public Economics xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Journal of Public Economics

journal homepage: www.elsevier.com/locate/jpube

Optimal management of transfers: An odd paradox

François Bourguignon[a,*], Jean-Philippe Platteau[b]

[a] Paris School of Economics, France
[b] University of Namur, Belgium

ARTICLE INFO

Keywords:
Transfer
Preference misalignment
Incentives
Aid

JEL classification:
I38
D02
D86
F35

ABSTRACT

This paper considers the case of transfers when there exists a serious preference misalignment between the transfer-maker and the beneficiary. The former wants to reduce the resulting outcome discrepancy through monitoring the use of the transfer and imposing sanctions if the discrepancy proves too large. This external discipline combines with the 'internal discipline' of the beneficiary, that is his/her willingness and ability to align with the transfer-maker's objective. Besides the fact that costs of monitoring and sanctioning are explicitly taken into account, an original feature of our model specification is that the two types of discipline are made comparable: they can be summed up to obtain an aggregate discipline. We show that, paradoxically, an (exogenous) improvement of internal discipline may be over-compensated by a fall of external discipline. Total discipline thus decreases and the discrepancy between the actual and the intended uses of the transfer increases instead of decreasing. Another consequence is that the relationship between internal and total disciplines may be non-monotonic. These results generalize to alternative specifications of the basic model.

1. Introduction

Anthony B. Atkinson's contribution to public economics through his own work, his founding of the Journal of Public Economics and its long held editorship of that journal has been monumental. Not only has he been among the few economists who provided a strong impetus to that area of economics, but he was also among those who were able to maintain it at the core of the discipline at a time where the dominant trend was in favour of ‘ minimizing the State’. The present paper is in the straight Atkinsonian tradition of transfer and redistribution policies in public economics. However, it is cast in a contract-theoretic framework that he did not generally adopt. It focuses on the general case where there is misalignment between the preferences of the transfer-maker and those of the transfer-receivers about the use to be made of a transfer. Misalignment may be direct or indirect, depending upon whether the misaligned preferences on the receiving side are those of the target beneficiaries themselves or those of an intermediary acting on their behalf.

The issue that first inspired this paper concerns the effectiveness of transfers made by the providers of Official Development Assistance, or aid, to poor people in recipient countries. Institutionally, these transfers must go through the ruling governments, which may use them in their own way. If in various instances Atkinson argued forcefully in favour of the Official Development Assistance, in particular in Proposition 15 of Atkinson (2015)[1], he paid comparatively little attention to its actual use and to the possible discrepancy between the donors' and the recipient governments' goals. Yet, the issue of the optimal manner in which the donors may ‘ discipline’ these governments so that they will comply as much as possible with their own preferences has become of considerable importance in the aid literature.[2] Interestingly enough, this approach and the resulting properties regarding the optimal management of transfers turn out to have wide application in public economics.

Consider an organization, say a state agency or a philanthropic organization, which wants to make transfers to people or groups of people in need. The beneficiaries are able to carry out actions that do not match the transfer-maker's objective, typically by diverting the money (or the in-kind transfers). They hold private information and there is therefore a serious problem of preference misalignment that the transfer-maker must mitigate. Towards that end, s/he uses a twin mechanism of monitoring and punishment conditional on fraud detection. S/he chooses the optimal levels of these two decision variables by explicitly taking into account the costs involved. An additional feature confers a specific dimension on our problem. The transfer-maker is sensitive to the extent to which s/he is able to increase the beneficiaries' wellbeing, as s/he perceives it, while the beneficiaries or the intermediary acting on their behalf have a limited capacity to self-control

* Corresponding author.
E-mail address: francois.bourguignon@psemail.eu (F. Bourguignon).

[1] See also Atkinson (2005).

[2] See Bourguignon et al. (2014) or Bourguignon and Gunning (2016).

https://doi.org/10.1016/j.jpubeco.2018.01.001
Received 18 July 2017; Received in revised form 31 December 2017; Accepted 2 January 2018
0047-2727/ © 2018 Published by Elsevier B.V.

Please cite this article as: Bourguignon, F., Journal of Public Economics (2018), https://doi.org/10.1016/j.jpubeco.2018.01.001

their drive to misuse the transfer or, in our own terminology, to exert internal discipline. This setup has some familiarity with a specific brand of public economics, known as non-welfarist welfare economics, which depicts the government as having an objective function different from that of individuals. In this approach, the outcomes of individual behaviour are evaluated using a preference function different from the one that generated the outcomes (Kanbur et al., 2006).

Our framework enables us to raise an interesting question that, to our knowledge, has been so far ignored by economists. How does the external discipline imposed by the transfer-maker combine with the internal discipline exerted by the beneficiaries? In particular, what is the effect of an exogenous improvement of internal discipline on the level of external discipline and ultimately on the outcome of the transfer as assessed by the transfer-maker? The question is far from trivial since the way external discipline, which is endogenous, responds to exogenous changes in internal discipline is crucial to determine how total discipline and the behaviour of the transfer-receiver are modified.

Applications of the above framework easily come to mind. Just think of problems of development aid, the point of departure of the present paper. When a donor organization wants to channel development aid to poor people in developing countries, it rightly worries about the possibility that a significant portion of the funds provided is misappropriated by local elites acting as intermediaries. In this instance, self-control by the beneficiaries most typically means their ability to limit the obnoxious actions of the intermediaries, that is, the quality of governance inside their polity. There is today an abundant literature attesting that such a worry is well-founded (see, for example, Olken, 2006; Easterly, 2007; Platteau et al., 2014).

As another example, consider the problem of a government that wants to reduce poverty but knows at the same time that some poor people are likely to misuse the money transferred either because of their drive to buy alcoholic beverages or drugs, or because of their vulnerability to the influence of doubtful intermediaries (including criminal gangs and drug cartels). In the same vein, microfinance institutions such as the Grameen Bank in Bangladesh strive to ensure that credit given to poor people for investment purposes is not diverted to consumption needs that are not viewed as a priority by the lending organization. Close monitoring and punishment (exclusion from the credit scheme) are resorted to with a view to mitigating the problem created by the inability of the target customers to credibly commit to using the loans as prescribed (for evidence on the self-control problem in poor rural communities, see for instance Datta and Mullainathan, 2014; Baland et al., 2011).

Moral hazard problems associated with conditional cash transfer programs are of a similar kind: the transfer is considered to be misused by the state if parents receive it while they have not fulfilled their promise to send their children to school, or if they exploit the opportunity of a transfer-in-kind by depriving the children freely fed at school of the evening meal they used to have at home (Jacoby, 2002). In the latter case, the money spared is put to uses that the parents, but not the state, prioritize. A last important illustration concerns social allowances, such as unemployment insurance or family allowances. Monitoring is required to check that the unemployed worker has applied enough job-search effort (Hopenhayn and Nicolini, 1997; Boone et al., 2007; Setty, 2015). The planner pays a monitoring cost and receives a signal that is correlated with the worker's job-search effort, which is private information. He uses that signal to improve the efficiency of the contract by conditioning future payments and the unemployment insurance contribution not only on the employment outcome, but also on the signal.

In all the foregoing examples, the question arises as to which intensity of monitoring and which level of punishment or penalty are optimal. Not surprisingly, such questions have received primary attention in the literature on crime. As expected, results hinge upon the assumptions made. For example, the classic Beckerian approach claims that social welfare is strictly increasing in the magnitude of the fine and extreme penalties are therefore socially optimal (Becker, 1974). By contrast, when enforcement of the penalty can be erroneous, or when there exists a difference in the objectives of the social planner and the implementing agency, which bears the cost of monitoring but retains a portion of the penalty revenue, non-maximal fines can be optimal (Chander and Wilde, 1992; Bose, 1995; Saha and Poole, 2000). In our own version, the same result is obtained because we reasonably assume that punishment always entails costs for the transfer-maker.

How substitutable are internal and external disciplines at equilibrium is the central issue addressed in the present paper. The following conclusion is reached: the transfer-maker is not only induced to substitute external for internal discipline but, when a change occurs in internal discipline, he may be induced to *over-compensate* it depending on the cost of external discipline. In particular, an increase in internal discipline may paradoxically lead to a fall in total discipline, which in turn causes the rate of the transfer's misappropriation to increase. Whether this happens or not depends not only on the initial level of internal discipline, but most importantly on the shapes of the cost functions. More precisely, if the internal discipline is initially of low quality and if the cost functions are moderately convex, two conditions that are by no means abnormally demanding, total discipline tends to fall when the internal discipline improves.

The implications of the uncovered paradox are hard to minimize. Compare two countries that distribute social subsidies to needy categories of people but the representative beneficiary in the first country is better disciplined internally than the representative beneficiary in the second country. For example, moral norms or peer pressures are more pervasive in the former country with the consequence that, other things being equal, the incidence of fraud is smaller. If the conditions of the paradox are satisfied, the providers of subsidies to the two countries adjust their external discipline in such a way that at equilibrium there will be more fraud in the country whose quality of internal governance is higher. Because the cost element is ignored, a simple comparison between the prevailing levels of fraud may therefore be misleading. When the marginal cost of external discipline is rising slowly, the transfer-maker's optimal policy may consist of reducing his disciplining effort so much that total discipline decreases. Clearly, cost saving should be taken into account before concluding that greater fraud in a country is due to less internal discipline.

The outline of the paper is as follows. In Section 2, the main assumptions behind the model are described while in Section 3, its building blocks are presented. In Section 4, we analyze the general case that obtains when the participation constraint of the transfer-receiver (or the intermediary) is not binding, leaving to Section 5 the simpler case where this constraint is binding. Section 6 investigates the robustness of the main results of the paper to alternative functional specifications of the basic model. Finally, Section 7 concludes by summarizing our main results. It also discusses the implications, on the level of both policy and empirics, of the basic mechanisms uncovered in the course of the analysis.

2. The setup of the model

In writing the model, we stick to a well-established tradition whereby problems of incentive alignment are analyzed within the Principal-Agent framework. We conceive of the Principal as a transfer-maker who is completely altruistic, and the Agent as the transfer-receiver or an intermediary between the transfer-maker and the target beneficiaries. The latter can be viewed either as a unique recipient of the transfer or as a representative type of multiple transfer-receivers. Because we deliberately focus on the interaction between internal and external disciplines, which requires an elaborate treatment, we have reserved for another paper the task of analyzing the multi-agent case in which one Principal and two heterogeneous agents are considered (see Bourguignon and Platteau, 2017).

Given the perspective that we adopt, a central question is how to

Download English Version:

https://daneshyari.com/en/article/7369444

Download Persian Version:

https://daneshyari.com/article/7369444

Daneshyari.com