



The principal-agent problem in economics and in politics

The principal-agent problem

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Abstract

Purpose – The purpose of this paper is to show that the assignment of right between the principal and the agent, under which the latter have the management of the assets that the former own, is similar to that between citizens and politicians in representative democracy, and it could, in both cases, turn in to a state of being a voluntary hostage for the principal.

Design/methodology/approach – Those who take decisions either in the economy or in society/politics, actually through their continuous presence and acting, set the frame under which decisions will be made, i.e. which behaviour is acceptable, rules of the games, codes and terminology, values and hierarchy among participants.

Findings – Since principals abstain from the everyday decision making either in economics or in politics, they lose the ability to influence the frame and the practices on how decisions are made, and therefore decisions are evaluated with the criteria established by agents and they are not those which principals would possibly have.

Practical implications – A part of the management of the assets of principals in the economy or the “asset of vote” of citizens, especially in the long run, actually is conducted by the agents (managers-politicians) to favour their own pursuits and not those of principals.

Originality/value – Under these circumstances the principal-agent problem, either in economics or in politics, has two alternative solutions: either principal should take over the management of his assets, or accept the state of being voluntary a hostage of his servants-agents (managers-politicians).

Keywords Democracy, Assets management, Decision making, Economics, Politics

Paper type General review

I.

The principal-agent problem in economics has to do with a contract between the owner of an economic or financial asset (principal) and a manager (agent). The owner assigns to the manager the right to administrate his asset, because he believes that himself has not the ability or the knowledge to confront market complexity and therefore he assigns the right of his asset's management to an agent-manager, looking for maximum returns in the short and the long run due to the efficient management from the agent-expert (see e.g. Tirole, 1995). The principal keeps agent under control, either through the results of his management (increase of returns) or in advance by inspecting his projects for restructuring and expansion. The owner can fire the manager if he thinks that the later does not act favourably to his asset's interest.

The agent takes the job and he is paid by fixed remuneration and by commissions and bonuses according to the increase in returns/profits or in sales and market share. The agent conceives what the owner expects through the assignment, but he feels or he is optimistic that there is room for chasing his own pursuits. He knows that his short-run management can be easily checked up by the owner for its efficiency, through the results of the accounting period along with increases in asset returns. However the long-run management has to do with the elaboration of business plans for expansion, change and restructuring. Because of possible differences in the degree of risk aversion and in asymmetric information between principal and agent, there is a moral hazard the agent



to transgress the contract (assignment of rights on asset management) without the principal having the ability to perceive it at the time that this is taking place.

The agent tries to understand his principal's attitude through his reactions to the business plans that he introduces. If principal is suspicious even in cases without reason, the agent either quits or is looking forward to be fired in order to receive the agreed compensation. If principal accepts his suggestions, agent will organize his long run presence, during which he will serve his principal's interests but he will drain a portion acting for his own inconspicuous pursuits, making two moves: First, he reorganizes and restructures his principal's asset arguing for better efficiency, seeking however for making his presence indispensable in this new functioning and therefore his possible future firing an expensive and costly move on behalf of the owner. Second, the projects he suggests have implicitly higher risk that the owner can afford and the agent is aware of it. However he is mostly concerned with the efficient and best elaboration than the outcome of the plan. When the outcome is good the owner takes the higher return and the manager takes the commissions and the bonuses but also the credits of the market, taking his carrier prospects off. When the outcome is bad the manager risks his dismissal but can still have the market's credits, if his plan was brilliant and efficiently worked out.

Why a plan's failure and the firing of the agent could not be encumbering for his future carrier as manager? This has to do with the way that markets are functioning and continually changing, therefore with the characteristics and the logic that has been consolidated up to the next structural change. The notional market place is the corpus of people that have an everyday presence in it and continually are acting and intervening. The way that they are behaving, when this becomes commonly acceptable, gives the attitude of the market, i.e. the codes, the criteria, the accepted practices, the language and terminology, etc. When principals exit from the market place after the assignment of their assets' management to agents, they are losing the ability to intervene and therefore influence the way that market is functioning, appraising business moves and accepting practices. The market is naturally attaching the mentality of the people that are present, and these are the agents. Since the way that agents are acting prevails in the market place, the evaluation of managers' competence becomes according to different criteria than those the owners/principals would have. The market is now rewarding action, risk and even spectacle. Since now in market place act the people that are not the owners of the assets, the market gives credit to the brilliant plan, the best elaborated and most sophisticated project, just like a teacher marks his students' examination papers. Furthermore, these people are attained to social and mental bonds between each other. From all the above, we can understand that the markets make and have the control on the pool of (well-paid) agents-managers and therefore the later are interested for the credits of the market and not the opinion of the assets' owners about their competence.

Now the problem is on owners. By assigning the right of management of their assets to managers and exiting from the market, the market became independent of their will and pursuits, and it attached the mentality of the managers. The owners fire the managers that bring bad results but they hire a new one from the same pool that the market has made, who has the same mentality as the previous that was fired as failed. The only way for the owners to break this vicious cycle that keeps them at a state of being voluntary hostages is to undertake themselves the management of their own assets, enter back in market place and fight for a market attached to the principals' and not to the agents' mentality and pursuits.

II.

In society principals are the citizens, i.e. all its adult members. The right that they assign for the short run is the decision making for the standard and quality of living. For the long run there are the choices on education-science-culture, social solidarity and public health, the deepening of democracy isonomy and human rights, improving the quality of life protecting also the natural environment and choices on issues of defense and diplomacy and international relations generally. Agents are common for all the society, even when major or minor pursuits of their principles are in conflict among them. Agents in representative democracy are the elected members of central government and local authorities or those who are in the minority.

Why the citizens assign their right on decision making for the issues which concern their society? Because political action is time consuming, in order someone to obtain all information and knowledge about these issues; time is also needed for deliberations and finally the implementation and imposition of chosen policy. Thus, citizens in order to remain focused on their everyday occupations assigned the right of everyday political decision making to agents-politicians, whom they elect at certain time points. I feel that a lot of citizens, who realize the responsibility which would undertake if they (as the corpus of citizens) had to make the everyday decisions about social and political issues, are relieved thinking that they are free of this burden of self-governance and I do not think that they would ever pass through their mind to accept to undertake it (as a corpus) in the future (during their life time). In order to see how serious the matter of self-governance through citizens' assembly is, let us bring back in mind how direct democracy had collapsed in ancient Athens since the end of fourth century BC, because of the contradictory and inconsistent decisions and verdicts that the people's assembly (the decision making body of Athens in golden era) was taken influenced by populists, quibblers and sophists who were practicing the rhetoric art.

At the era of civic democracy, agents-politicians were representing the majority of their principals-voters, they were serving their wishes and they were coming from their social and economic classes. When agents became professional politicians and cut off the bonds with their voters, they adopted the same behaviour as the agents-managers of economic and financial markets (see Hirschman, 1970). Thus in our days, when agents-politicians win the nomination, they have as basic pursuit their survival in the profession of politics and governance (see Kondylis, 1991). What is happening now in politics is relevant to what is happening in the economy. Principal-agency theory has evolved significantly as political scientists have sought to make it more applicable to peculiarly political institutions (see e.g. the recent review by Miller, 2005). Awareness of the problem of credible commitment has impelled more dramatic reformulations in which agents perform their function only when their interests conflict with those of the principal, and they are guaranteed some degree of autonomy.

The exercise of governance and of politics generally adopts the attitudes (codes, language, practices, etc.) of agents-politicians, and therefore the later form a political elite (a pool of agents-politicians) independent of social stratification. From this pool are deterministically elected the agents who govern and those of the opposition who wait to govern and complete the political stage. The question is how these agents succeed to preserve their position in the pool, since social issues are more crucial and broader than those in the economy and furthermore social changes usually bring major upsetting.

Agents in politics use the following patterns: First they use certain rhetoric which focuses on certain words or expressions, which have been consolidated since the period of the regime change. In these words and expressions society is trained (through

continuous repetition) to listen and obey, up to the next regime change. By this rhetoric, certain issues and certain viewpoints are exiled from the discussions and decision making deliberations and they are never put forward. Agents (either in government or in opposition) are making those political choices which will not hazard their political future, i.e. choices which are acceptable and compatible with the established mentality of domestic and international political elites. The role of agents in opposition (possibly members of future government) is also crucial, and can be argued that it focuses in superlative degree to the deficiencies of the government's choices, and therefore it is bringing up more confusion and making more difficult for the principals-voters to understand which is the point of view and conflict. Therefore citizens-voters are trained to be incompetent to comprehend the issues on the political agenda and have the ability of choices' evaluation. That is why voters are stuck to the decision and the valuation that the political party or politician of their preference is making rather than trying to attempt expressing their own opinion (see Downs, 1957). Hence voters have through time real ignorance about the crucial choices of the society in short and especially the long run.

Here we should point out the role of internationalization of the domestic political elites because of the continuous contacts they have through the augmenting international activities and participation of the nations in any kind of supranational and international organizations, unions and alliances. Through these contacts, elites are making new professional and social bonds, enrich their practices, help each other to confront domestic difficulties, and create international codes values and expressions which facilitate them to establish their dominance in the political life of their country. Agents-politicians check the tensions in the way of thinking of the citizens and how they are looking the political arena through public opinion researches and investigations. Working out results from these researches, politicians may decide to change respectively the undertones of their speeches or make some tactical movements. They flatter continually their audience and try to abstract their minds in minor issues or in sentimental and pleasant scenes. By this way they try and usually succeed to deter the entrance in new waves (ideas and persons) in political stage. Elections are the crucial time point, where citizens votes for their representatives and government. The vote is all that the political agents need from principals. All the plot is how to persuade citizens to vote them, and if they are disappointed by them how for just this moment of election citizens can excuse the politicians for the last time (up to the next) and give them another chance.

For the above we can see that the assignment of right between citizens and politicians has been turn up to the state of citizens becoming voluntary hostages since political action and decision making have gradually become independent of their will, wishes and their needs' satisfaction. Kontogiorgis (2003) argues that the autonomy of authorities infers the non-autonomy of the social body. Politics have attached the attitudes of the professional politicians and actually serve the pursuits of these who govern or generally participate in political market and not of those (citizens) who physically abstain and just elect their representatives.

III.

Summing up the assignment of rights in the economy (on behalf of the owner of an economic or financial asset) or in the society (on behalf of the corpus of citizens) could turn out to the state of being voluntary a hostage because of the exit of principals (owners or citizens) from the everyday decision making process either in market place or for issues concerning political choices of the society. Then market or political arena

(as a corpus of the people who are continually acting and participating in these places) becomes gradually independent of the will of principals who assigned their rights to agents and attaches attitudes (codes, behaviour, language, values and practices) which are compatible with the objectives of agents-managers either in the economic fields or in social matters (politics).

Under these circumstances there is room for conspiracy even under free market economy and the political regime of representative democracy. When principals abstain from the place where decisions are made, agents put the frame on how this will take place, i.e. under which practices codes behaviours, etc. By putting the frame agents have the control on which issues are discussed and on which sides they focus. Controlling the frame, they also control how the frame is moving and changing through time, in order to retain the assignment of rights from the principals only to themselves.

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