

Comment 2 on Workshop in Political Institutions

Principal-Agent Relationships

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In recent decades, economic analysis has been extended to situations in which there are important asymmetries of information between actors. One important class of these situations are principal-agent relationships, in which one party, the agent, acts on behalf of the other, the principal. In such situations of incomplete and asymmetric information (in which the agent may be better informed than the principal), is it possible to devise mechanisms to ensure that the agent acts in the best interests of the principal? How can we construct relationships so that physicians act in the best interests of patients, lawyer in the best interests of their clients, or public officials in the best interests of their constituents?

When complex, multilayered problems such as those associated with global warming are being considered, the concept of principal-agent relationships has two important applications. First the concept of the ideal principal-agent relationships can be used as a normative standard. Under ideal circumstances, leaders (agents) of groups (such as nation states) will negotiate to maximize net social benefits on behalf of their constituents (the principals). Thus one could examine the set of feasible agreements that could occur if there was perfect agency (i.e., situation in which agent acts in

the best interests of the principal) among all of those who took part in a given round of international (or national or subnational) negotiations.

Second, recognizing that perfect agency does not accurately characterize most regimes, one could examine the likely set of feasible agreements in actual practice. Even in democratic systems, imperfectly competitive political arenas mean that narrow, well-organized special interests are often disproportionately represented relative to the general social interest. In less accountable regimes, the scope for the agents to pursue their own interests at the expense of the principals is often quite substantial.

Principal-agent relationships are also relevant in a situation of decomposable, nested hierarchies. Such hierarchies may be a mechanism through which coordination on a global scale may be achieved in a relatively decentralized fashion. In such hierarchies, the leader of a small-scale group would act as agent on behalf of the members when negotiating with higher levels in the hierarchy. Such systems of nested hierarchies would appear to be of great relevance in the context of issues of the global commons.