Inside Organizations: Pricing, Politics, and Path-Dependence
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Abstract

When economists have considered organizations, much attention has focused on the boundary of the firm, not its internal structures and processes. In contrast, this essay sketches three approaches to the economics of internal organization—one substantially developed, another recently evolving, and a third on the horizon. First, the “pricing” approach is Pigouvian: if markets get the prices wrong (say, because of externalities), then the economist’s job is to fix the prices (say, through a tax). The resulting “incentive system” models ask not only what prices should be attached to various actions inside organizations, but also what direct and indirect methods are available to set these prices. Second, the “political” approach continues to focus on incentives, but now addresses environments where important actions inside organizations simply cannot be priced, directly or indirectly. As a result, control becomes a central focus in models of battles for control, orchestrating control, influencing those in control, and so on. Finally, the “path-dependence” approach shifts attention from the “between” variance to the “within.” That is, rather than ask how organizations confronting different circumstances should choose different structures and processes, the focus here is on how path-dependence can cause seemingly similar organizations to perform at persistently different levels.