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Economics 283: Topics in Contracts and Organizations

Description

This is an advanced Ph.D. course in the field of Microeconomic theory (J2). It examines recent developments in the theory of contracts and organizations. This year the course will consist of four parts. Part I will examine models where agents' incentives are provided by reputational concerns. Part II will study implicit contracts in long-term relationships, and their interaction with explicit contracts. Part IV will examine communication without commitment, or "cheap talk." Part III will consider the communication requirements of economic mechanisms.

Prerequisites

Economics 202, 203, and 282, or consent of instructors

Requirements

The main objective of the course is to provide a smooth transition for students from studying the research of others to doing one's own. In accordance with this objective, each student taking the class for credit will be required to (i) give a class presentation, and (ii) write a paper on a topic of his or her choosing. The topic should be broadly related to the class material. The student presentation and paper should provide a critical analysis of one or more recent research articles, and, ideally, propose directions for immediate further research. Students are invited, but not restricted, to choose from articles on the reading list below that are marked with '■'.

Presentations: Each class presentation will last for 50 minutes. Each student should meet early in the course with one of the instructors to discuss his/her presentation topic. Presentations will be scheduled for the last third of the course.

Papers: should be between 10 and 15 pages long. All papers are due on June 3— no exceptions.

Readings

Articles marked with a star (★) are highly recommended. The other articles are supplemental. The electronic version of this document contains hyperlinks to those articles that are available on the Web in PDF format (note that JSTOR can only be accessed from the Stanford domain). The articles that are not available on the Web will be placed in the 2nd-floor lounge in Landau.

I. Reputational Incentives

1. Career Concerns and “Signal Jamming” Models

Fama, E.F. (1980), “Agency Problems and the Theory of the Firm,” *Journal of Political Economy*, 88(2): 288-307

- ★ Holmstrom B., (1999) “Managerial Incentive Problems: A Dynamic Perspective,” *Review of Economic Studies*, 66(1): 169-182

Holmstrom B. and J. Ricart i Costa (1985), “Managerial Incentives and Capital Management,” *Quarterly Journal of Economics*, 101(4): 835-860

- ★ Gibbons, R. and K.J. Murphy (1992), “Optimal Incentive Contracts in the Presence of Career Concerns: Theory and Evidence,” *Journal of Political Economy*, 100(3): 468-505.

- Dewatripont, M., I. Jewitt and J. Tirole (1999) “The Economics of Career Concerns, Part I: Comparing Information Systems,” *Review of Economic Studies*, 66(1): 183-198
- Dewatripont, M., I. Jewitt and J. Tirole (1999) “The Economics of Career Concerns, Part II: Applications to Missions and Accountability of Government Agencies,” *Review of Economic Studies*, 66(1): 199-217
- Prendergast, C. and L. Stole (1996) “Impetuous Youngsters and Jaded Old-timers: Acquiring a Reputation for Learning,” *Journal of Political Economy*, 104: 1105-1134
- Meyer, M., and J. Vickers (1997) “Performance Comparisons and Dynamic Incentives,” *Journal of Political Economy*, 105(3): 547-581

2. Signaling Models of Reputation

- ★ Kreps, D., P. Milgrom, J. Roberts and R. Wilson (1982) “Rational Cooperation in the Finitely Repeated Prisoners' Dilemma,” *Journal of Economic Theory*, 27(2): 245-252
- ★ Diamond, D. (1989), “Reputation Acquisition in Debt Markets,” *Journal of Political Economy*, 97(4): 828-862
- Horner, J. (2001) “Reputation and Competition,” forthcoming, *American Economic Review*
- Phelan, C. (2004) “Public Trust and Government Betrayal,” mimeo, Federal Reserve Bank of Minneapolis

3. Reputation as a Tradeable Asset and Incentive Provision

- ★ Kreps, D. (1990) “Corporate Culture and Economic Theory,” in J. Alt and K. Shepsle, Eds. *Perspectives on Positive Political Economy*, Cambridge University Press
- Tadelis, S. (1999) “What’s in a Name? Reputation as a Tradeable Asset,” *American Economic Review*, 89(3): 548-63
- ★ Tadelis, S. (2001) “The Market for Reputations as an Incentive Mechanism,” *Journal of Political Economy* 110(4):854-882
- ▣ Tadelis, S. (2003), “Firm Reputation with Hidden Information” *Economic Theory*, 21(2-3):635-651
- ▣ Mailath, G., and L. Samuelson (2001), “Who Wants a Good Reputation?” *Review of Economic Studies*, April (reprinted with typo corrections in July)

II. Relational Contracts

- ▣ Bernheim, B.D. and M.D. Whinston (1998), “Incomplete Contracts and Strategic Ambiguity,” *American Economic Review*, 88: 902-32
- MacLeod W.B., and J.M. Malcomson (1989) “Implicit Contracts, Incentive Compatibility, and Involuntary Unemployment,” *Econometrica*, 57(2): 447-480
- ▣ Baker, G., R. Gibbons, and K.J. Murphy (1994) “Subjective Performance Measures in Optimal Incentive Contracts,” *Quarterly Journal of Economics*, 109: 1125-1156
- ★ Levin, J. (2001) “Relational Incentive Contracts,” mimeo, Stanford University
- ★ Athey, S. and K. Bagwell (2001) “Optimal Collusion with Private Information,” *Rand Journal of Economics*, 32(3): 428-465.
- Athey, S., K. Bagwell and C. Sanchirico (2000) “Collusion and Price Rigidity,” mimeo, Stanford University
- ▣ Levin, J. (2001) “Multilateral Contracting and the Employment Relationship,” *Quarterly Journal of Economics*, forthcoming

III. Organizational Form

- ★ Garicano, L. and T. Santos (2004) “Referrals,” *American Economic Review*, forthcoming.

- ★ Levin, J. and S. Tadelis (2004) “Profit Sharing and the Role of Professional Partnerships,” mimeo, Stanford University
 - Morisson A. and W. Wilhelm (2004) “Partnership Firms, Reputation and Human Capital,” mimeo, McIntire School of Business
- Hansmann, H. *The Ownership of Capital*, 1996, Harvard University press
- Easley D. and M. O’Hara (1983) “The Economic Role of the Nonprofit Firm,” *Bell Journal of Economics*, 14(2): 531-538
 - Glaeser E. and A. Shleifer (2001) “Non-for-profit Entrepreneurs,” *Journal of Public Economics*, 81(1): 99-115

IV. The Communication Requirements of Social Choice Rules

1. Deterministic vs. Nondeterministic Communication. Role of Prices.

- ★ Hayek, F. (1945) “The Use of Knowledge in Society.” *American Economic Review* 35: pp. 519-30
- ★ Kushilevitz, E., and N. Nisan (1997), *Communication Complexity*. Cambridge University Press, pp. 3-27
- ★ Segal, I., “The Communication Requirements of Social Choice Rules and Supporting Budget Sets”

2. The Communication Burden in Economic Environments

- ★ Hurwicz, L. (1986) “On Informational Decentralization and Efficiency in Resource Allocation Mechanisms,” in S. Reiter, ed., *Studies in Mathematical Economics*, the Mathematical Association of America, pp. 238-278.
- Mount, K., and S. Reiter (1974) “The Informational Size of Message Spaces,” *Journal of Economic Theory* 28, pp. 1-18
- Hurwicz, L. (1977), “General Characterizations of Allocation Processes,” in K. Arrow and L. Hurwicz, eds., *Studies in Resource Allocation Processes*, Cambridge University Press, pp. 393-462
- ★ Calsamiglia, X. (1977) “Decentralized Resource Allocation and Increasing Returns,” *Journal of Economic Theory* 14: 262-283

★ Nisan, N., and I. Segal (2002) “The Communication Complexity of Efficient Allocation Problems,” working paper

Segal, I. “Communication Complexity and Coordination by Authority,” working paper

Blumrosen, L., N. Nisan, and I. Segal (2004) “Auctions with Severely Bounded Communication”

- Marschak, T., and S. Reichelstein (1998) “Network Mechanisms, Informational Efficiency, and Hierarchies,” *Journal of Economic Theory* 79(1): 106-141
- Reichelstein, S. (1984) “Incentive Compatibility and Informational Requirements,” *Journal of Economic Theory* 34(1), 32-51

V. Communication without Commitment

1. Sender-Receiver Games

★ Crawford, V., and J. Sobel (1982) “Strategic Information Transmission,” *Econometrica* 50(6): 1431-1451

- Bester, H., and R. Strausz (2001) “Contracting with Imperfect Commitment and the Revelation Principle: The Single Agent Case,” *Econometrica* 69(4): 1077-1098

2. Equilibrium Refinements

★ Farrell, J. (1993) “Meaning and Credibility in Cheap Talk Games,” *Games and Economic Behavior* 5(4): 209-14

Farrell, J., and M. Rabin, (1996) “Cheap Talk,” *Journal of Economic Perspectives* 10(3): 103-118

- Rabin, M. (1990) “Communication between Rational Agents,” *Journal of Economic Theory* 51: 244-170
- Matthews, S., M. Okuno-Fujiwara, and A. Postlewaite (1991), “Refining Cheap-Talk Equilibria,” *Journal of Economic Theory* 55: 247-73
- Baliga, S., and S. Morris (2002) “Coordination, Spillovers, and Cheap Talk,” *Journal of Economic Theory*, 105: 450-468.

3. Delegation

★ Dessein, W. (2002) “Authority and Communication in Organizations” *Review of Economic Studies* 69: 811-838

Holmstrom, B. (1984) “On the Theory of Delegation,” in M. Boyer and R. Kihlstrom, eds., *Bayesian Models in Economic Theory*, Elsevier, 1984

■ Morgan, J., and P. Stocken (2003), “An Analysis of Stock Recommendations,” *Rand Journal of Economics* 34(1): 183-203

■ Ottaviani, M., and F. Squintani (2004) “Non-Fully Strategic Information Transmission,” working paper

4. Reputational Concerns

★ Sobel, J. (1985) “A Theory of Credibility,” *Review of Economic Studies* 52: 555-573

★ Ely, J. and J Valimaki (2003) “Bad Reputations,” *Quarterly Journal of Economics* 118(3): 785-814

■ Morris, S. (2001), Political Correctness, *Journal of Political Economy* 109(2): 231-265

■ Olszewski, W. (2003) “Informal Communication,” *Journal of Economic Theory*, forthcoming

■ Hermalin, B. “The Boy Who Cried Wolf: Is Honesty the Best Policy?” SSRN working paper

Ottaviani, M., and P. Sorensen (2001) “Professional Advice”

■ Ottaviani, M., and P. Sorensen (2001) “Information Aggregation in Debate: Who Should Speak First?” *Journal of Public Economics* 81(3): 393-421

5. Mediated vs. Unmediated Communication

★ Myerson, R. (1991) *Game Theory: Analysis of Conflict*. Harvard University Press, pp. 244-263, 283-288

Aumann, R. (1987) “Correlated Equilibrium as an Extension of Bayesian Rationality,” *Econometrica* 55: 1-18

Fudenberg, D., and J. Tirole, (1992) *Game Theory*, MIT Press, pp. 53-59

Myerson, R. (1982) "Optimal Coordination Mechanisms in Generalized Principal-Agent Problems," *Journal of Mathematical Economics* 10: 67-81

★ Forges, F. (1990) "Universal Mechanisms," *Econometrica* 58: 1341-1364

■ Baliga, S., and T. Sjostrom (2003) "Arms Races and Negotiations," forthcoming in *Review of Economic Studies*.

■ Aumann, R., and S. Hart (2003) "Long Cheap Talk," *Econometrica* 71(6): 1619-1660

■ Gerardi, D. (2004) "Unmediated Communication in Games with Complete and Incomplete Information" *Journal of Economic Theory* 114: 104-131.

6. Applications

★ Matthews, S., and A. Postlewaite (1989) "Pre-play Communication in Two-Person Sealed-Bid Double Auctions," *Journal of Economic Theory* 48: 238-263

Farrell, J., and R. Gibbons (1989) "Cheap Talk Can Matter in Bargaining," *Journal of Economic Theory* 48: 221-237

★ Austen-Smith, D. (1993) "Interested Experts and Policy Advice: Multiple Referrals under Open Rule," *Games and Economic Behavior* 5(1): 3-43

Wolinsky (2001) "Eliciting Information from Multiple Experts," *Games and Economic Behavior* 41(1): 141-160

★ Battaglini, M. (2002) "Multiple Referrals and Multidimensional Cheap Talk," *Econometrica* 70(4): 1379-1401

■ Krishna, V., and J. Morgan (2001) "A Model of Expertise," *Quarterly Journal of Economics* 116(2): 747-775

■ Farrell, J., and R. Gibbons, (1989) Cheap Talk with Two Audiences, *American Economic Review* 79(5): 1214-23

7. Disclosure of Certifiable Information

★ Milgrom, P. (1981) "Good News and Bad News: Representation Theorems and

Applications.” *Bell Journal of Economics* 21: 380-391

Milgrom, P. and J. Roberts (1986) “Relying on the Information of Interested Parties,” *RAND Journal of Economics*, 17(1): 18-32

Seidmann, D., and E. Winter (1997) “Strategic Information Transmission with Verifiable Information,” *Econometrica* 65(1): 163-169

Okuno-Fujiwara, M., A. Postlewaite, and K. Suzumura (1990), “Strategic Information Revelation,” *Review of Economic Studies* 57: 25-47

H. S. Shin (1994), “News Management and the Value of Firms,” *RAND Journal of Economics* 25(1): 58-71

■ Shin, H.S. (2003), “Disclosures and Asset Returns,” *Econometrica* 71(1): 105-133