

Econ 224 and PHDBA279D
The Economics of Institutions

Meeting days: Tuesdays 1:00-3:00 pm

Location: Haas F555

Office Hours: by appointment

Description

This course is aimed at PhD students in Economics and in Business and Public Policy with the goal of developing a deeper understanding of economic and political institutions, and their influence on economic activity. The course will provide students with conceptual and theoretical frameworks that have wide applicability, with an eye toward applying these frameworks to understand observable phenomena, guide strategy and inform policy.

Prerequisites

Microeconomic Theory at the PhD level and some PhD applied econometrics. We know that the first-year students lack this prerequisite and we will try to fill in some gaps as we go along.

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. As such, you are required to submit a short term paper at the end of the course. You will also be required to present summaries of two papers, each being about 15 minutes long. Your presentation should focus on the relation to what we have learned, what the contribution is, and what possible concerns you have with the paper's contribution. Finally, active participation may also influence your final grade.

Readings

Articles marked with a star (★) are required reading and will be covered extensively in class. The other articles are supplemental and will be referred to as needed. Articles marked with ♀ will be assigned for student presentations in lectures #7 (3/1/2011) and #14 (4/26/2011).

1. Agency and Incentives (1/18/11)

- ★ Holmström, Bengt (1979) “Moral Hazard and Observability.” *Bell Journal of Economics* **10(1)**: 74-91.
- ★ Gibbons, Robert (1998) “Incentives in Organizations” *The Journal of Economic Perspectives*, **12(4)**:115-132.
- ★ Prendergast, C. 1999. “The Provision of Incentives in Firms.” *Journal of Economic Literature*, **37(1)**:7-63
- Holmstrom, Bengt and Paul Milgrom (1991) “Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design,” *Journal of Law, Economics, and Organization*, **7(0)**:24-52
- ♀ Ferrall, Christopher and Bruce Shearer (1999) “Incentives and Transactions Costs Within the Firm: Estimating an Agency Model Using Payroll Records,” *Review of Economic Studies*, **66(2)**:309-338.

2. Agency and Organization (1/25/11)

- ★ Alchian, Armen A. and Harold Demsetz, 1972, Production, Information Costs, and Economic Organization, *American Economic Review*, Vol. 62, No. 5. (Dec., 1972), pp. 777-795. Available in JSTOR.
- ★ Holmstrom, Bengt (1982) “Moral Hazard in Teams,” *Bell Journal of Economics* **13(2)**:324-340
- Jensen, Michael C., and Meckling, William H. (1976) “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” *Journal of Financial Economics* **3**: 305-60.
- Fama, Eugene F. and Michael C. Jensen (1983) “Separation of Ownership and Control,” *Journal of Law and Economics*, **26(2)**:301-325.
- Holmstrom, Bengt and Paul Milgrom (1994) “The Firm as an Incentive System,” *American Economic Review* **84(4)**:972-991
- ♀ Griffith, Rachel and Andrew Neely (2009) “Performance Pay and Managerial Experience in Multitask Teams: Evidence from within a Firm,” *Journal of Labor Economics*, **27(1)**:49-82.

3. Transaction Costs, Property Rights and Organization (2/1/11)

- ★ Coase, Ronald 1937, "The Nature of the Firm," *Economica*, Available in JSTOR
- ★ Williamson, Oliver, 1979. "Transaction-Cost Economics: The Governance of Contractual Relations," *Journal of Law and Economics*, Vol. 22, No. 2. (Oct., 1979), pp. 233-261. Available in JSTOR.
- ★ Klein, Benjamin, Robert G. Crawford, and Armen A. Alchian (1978) "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process," *Journal of Law and Economics*, 21(2):297-326.
- ★ Grossman, Sanford, and Oliver Hart (1986). "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration," *Journal of Political Economy*, 94(3) pp. 691-719.
- ★ Barzel, Yoram (1982) "Measurement Cost and the Organization of Markets," *Journal of Law and Economics*, 25(1):27-48

Hart, Oliver, *Firms, Contracts and Financial Structure*, Oxford, Oxford University Press, 1995.

- ♀ Hart, Oliver, Shleifer, Andrei and Vishny, Robert (1997) "The Proper Scope of Government: Theory and an Application to Prisons," *Quarterly Journal of Economics*, 112(4):1127-61

Hart, Oliver and John Moore (1990) "Property Rights and the Nature of the Firm," *Journal of Political Economy*, Vol. 98(6), pp. 1119-1158

Gibbons, Robert (2005) "Four formal(izable) theories of the firm," *Journal of Economic Behavior and Organization*, 58 (2):200-245.

Williamson, Oliver E., (1971), "The Vertical Integration of Production: Market Failure Considerations," *American Economic Review*, 61(1):112-23.

Williamson, Oliver, 1983. "Credible Commitments: Using Hostages to Support Exchange," *American Economic Review*, 73(4):519-540.

Williamson, Oliver, 1991, "Comparative Economic Organization: The Analysis of Discrete Structural Alternatives," *Administrative Science Quarterly*, Vol. 36, No. 2. pp. 269-296. Available in JSTOR.

- ♀ Masten, Scott E., James W. Meehan, Jr. and Edward A. Snyder (1991) "The Costs of Organization" *Journal of Law, Economics, and Organization*, 7(1):1-25

4. Incentives versus Transaction Costs (2/8/11)

★ Bajari, Patrick and Steven Tadelis (2001) "Incentives Versus Transaction Costs: A Theory of Procurement Contracts." *RAND Journal of Economics* **32(2)**:387-407.

★ Tadelis, Steven and Oliver Williamson (2011) "Transaction-Cost Economics," to appear in Robert Gibbons and John Roberts, Eds. *The Handbook of Organizational Economics*, Princeton University Press

★ Holmstrom, Bengt and John Roberts (1998) "The Boundaries of the Firm Revisited," *Journal of Economic Perspectives*, **12(4)**:73-94.

Holmstrom, Bengt (1999) "The Firm as a Subeconomy," *Journal of Law, Economics, and Organization* **15(1)**:74-102.

♀ Bajari, Patrick, Stephanie Houghton and Steven Tadelis (2010) "Bidding for Incomplete Contracts: An Empirical Analysis," mimeo

Forbes, Silke J. and Mara Lederman, (2010) "Adaptation and Vertical Integration in the Airline Industry," *American Economic Review*

♀ Forbes, Silke J. and Mara Lederman, (2010) "The Performance Implications of Vertical Integration: Evidence from the Airline Industry," forthcoming *Rand Journal of Economics*

Levin, Jonathan and Steven Tadelis (2010) "Contracting for Government Services: Theory and Evidence from U.S. Cities," *Journal of Industrial Economics*.

5. Relational Contracts and Trust (2/15/11)

★ Levin, Jonathan (2003) "Relational incentive contracts," *American Economic Review*, **93(3)**:835–857.

★ MacLeod, W. Bentley (2003), "Optimal Contracting with Subjective Evaluation," *American Economic Review* **93(1)**:216-40.

MacLeod, W. Bentley, and James Malcomson, "Implicit Contracts, Incentive Compatibility, and Involuntary Unemployment," *Econometrica*, LVII (1989), 447– 480.

Telser, Lester, 1981. "A Theory of Self-Enforcing Agreements," *Journal of Business*, 27-44.

Klein, Benjamin and Keith B. Leffler, 1981. "The Role of Market Forces in Assuring Contractual Performance," *The Journal of Political Economy*, Vol. 89, No. 4. pp. 615-641. JSTOR.

♀ Brown, Martin, Armin Falk and Ernst Fehr (2004) "Relational Contracts and the Nature of Market Interactions," *Econometrica*, **72(3)**:747-780

♀ Corts, Kenneth and Jasjit Singh (2004) "The Effect of Repeated Interaction on Contract Choice: Evidence from Offshore Drilling," *Journal of Law, Economics and Organizations* **20(1)**:230-260.

6. Knowledge, Hierarchies and Specialization (2/22/11)

★ Hayek, F. A. "The Use of Knowledge in Society," *American Economic Review* **35(4)**:

★ Garicano, Luis (2000) "Hierarchies and the Organization of Knowledge in Production," *Journal of Political Economy*, **108(5)**:874-904.

★ Antràs, Pol, Luis Garicano and Esteban Rossi-Hansberg (2006) "Outsourcing in a Knowledge Economy." *Quarterly Journal of Economics*, **121(1)**:31-77.

Qian, Yingyi (1994) "Incentives and Loss of Control in an Optimal Hierarchy," *Review of Economic Studies*, **61(3)**:527-544

♀ Garicano, Luis and Thomas Hubbard (2007) "Managerial Leverage is Limited by the Extent of the Market: Hierarchies, Specialization, and the Utilization of Lawyers' Human Capital." *Journal of Law & Economics*, pp:1-43.

Garicano, Luis and Tano Santos, 2004. "Referrals," *American Economic Review* **94(3)**:499-525.

7. Student Presentations (3/1/11)

Selected from articles marked with ♀ above.

8. Property Rights Institutions, Political Institutions and Development (3/8/11)

- ★ North, Douglass C. and Barry R. Weingast (1989). "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *Journal of Economic History*, 49, pp. 803-832.
- ★ Acemoglu, Daron, Simon Johnson, and James Robinson (2005). "The Rise of Europe: Atlantic Trade, Institutional Change, and Economic Growth," *American Economic Review*, 95, pp. 546-79.
- ★ Naidu, Suresh (2010). "Suffrage, Schooling, and Sorting in the Post-Bellum U.S. South," Columbia University, working paper.
- ★ Hornbeck, Richard (2010). "Barbed Wire: Property Rights and Agricultural Development," *Quarterly Journal of Economics*, 125, pp. 767-810.
- ♀ Acemoglu, Daron, Simon Johnson, and James Robinson (2001). "The Colonial Origins of Comparative Development: An Empirical Investigation," *American Economic Review*, 91, pp. 1369-1401.
- ♀ Acemoglu, Daron and James A. Robinson (2000). "Why Did the West Extend the Franchise? Growth, Inequality and Democracy in Historical Perspective," *Quarterly Journal of Economics*, 115, pp. 1167-99.
- ♀ Dal Bo, Ernesto, Pedro Dal Bo, and Jason Snyder (2009). "Political Dynasties," *Review of Economic Studies*, 76, pp. 115-42.
- ♀ Besley, Timothy and Torsten Persson (2009). "State Capacity, Conflict, and Development," *Econometrica*, 78, pp. 1-34.

9. Informal institutions: trust and social norms (3/15/11)

- ★ Greif, Avner (1993). "Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition," *American Economic Review*, 83, pp. 525-48.
- ★ Clark, Gregory (1987). "Why Isn't the Whole World Developed? Lessons from the Cotton Mills," *Journal of Economic History*, 47, pp. 141-73.
- ★ Shue, Kelly (2010). "Executive Networks and Firm Policies: Evidence from the Random Assignment of MBA Peers," Harvard University, working paper.

♀ Bertrand, Marianne (2004). "From the Invisible Handshake to the Invisible Hand? How Import Competition Changes the Employment Relationship," *Journal of Labor Economics*, 22, pp. 723-65.

Williamson, Oliver E. (1993). "Calculativeness, Trust, and Economic Organization," *Journal of Law, Economics, and Organization*, 36, pp. 453-86.

3/22/11: SPRING BREAK

10. Legal Institutions and "Development" (3/29/11)

★ Djankov, Simeon, Oliver Hart, Caralee McLiesh, and Andrei Shleifer (2009). "Debt Enforcement around the World," *Journal of Political Economy*, 116, pp. 1105-48.

★ La Porta, Rafael, Florencio Lopez de Silanes, and Andrei Shleifer (2008). "The Economic Consequences of Legal Origins," *Journal of Economic Perspectives*, 46, pp. 285-332.

★ Cantoni, Davide and Noam Yuchtman (2010). "Medieval Universities, Legal Institutions, and the Commercial Revolution," UC-Berkeley, working paper.

Glaeser, Edward L. and Andrei Shleifer (2004). "Legal Origins," *Quarterly Journal of Economics*, 117, 1193-1229.

11. Forms of Organizations (4/5/11)

★ Hansmann, Henry (1988). "Ownership of the Firm," *Journal of Law, Economics, & Organization*, 4, pp. 267-304.

★ Bubb, Ryan and Alex Kaufman (2009). "Consumer Biases and Firm Ownership," NYU Law School, working paper.

★ Levin, Jonathan and Steven Tadelis (2005). "Profit Sharing and the Role of Professional Partnerships," *Quarterly Journal of Economics*, 120, pp. 131-

♀ Hart, Oliver and John Moore (1998). "Cooperatives vs. Outside Ownership," NBER Working Paper No. 6421.

Hansmann, Henry and Reinier Kraakman (2000). "The Essential Role of Organizational Law," Yale Law School, working paper.

12. Labor Contracts and Labor Market Institutions (4/12/11)

- ★ Acemoglu, Daron and Jorn-Steffen Pischke (1998). “Why Do Firms Train? Theory and Evidence,” *Quarterly Journal of Economics*, 113, pp. 79-119.
- ★ Manning, Alan (2003). “The Real Thin Theory: Monopsony in Modern Labour Markets,” *Labour Economics*, 10, pp. 105-31.
- ★ Naidu, Suresh and Noam Yuchtman (2010). “How Green Was My Valley? Coercive Contract Enforcement in 19th Century Industrial Britain,” UC-Berkeley, working paper.
- ♀ Bertrand, Marianne and Sendhil Mullainathan (2001). “Are CEO’s Rewarded for Luck? The Ones Without Principals Are,” *Quarterly Journal of Economics*, 116, pp. 901-32.
- ♀ Marinescu, Ioana (2009). “Job Security Legislation and Job Duration: Evidence From the UK,” *Journal of Labor Economics*, 27, pp. 465-86.
- ♀ Lee, David S. and Alexandre Mas (2009). “Long-Run Impacts of Unions on Firms: New Evidence from Financial Markets, 1961-1999,” NBER Working Paper #14709.
- ♀ Brenner, Dror and Yona Rubinstein (2010). “Pride and Prejudice: Evidence from the ‘Promised Land,’” Brown University, working paper.

13. Incentives in Organizations (4/19/11)

- ★ Lazear, Edward P. (2000). “Performance Pay and Productivity,” *American Economic Review*, 90, pp. 1346-61.
- ★ Bandiera, Oriana, Iwan Barankay, and Imran Rasul (2007). “Incentives for Managers and Inequality Among Workers: Evidence From a Firm-Level Experiment,” *Quarterly Journal of Economics*, 122, pp. 729-773.
- ★ Ichniowski Casey, Kathryn Shaw, and Giovanna Prennushi (2007). “The Effects of Human Resource Management Practices on Productivity: A Study of Steel Finishing Lines,” *American Economic Review*, 87, pp. 291-313.
- ♀ Freeman, Richard B. and Morris M. Kleiner (2005). “The Last American Shoe Manufacturers: Decreasing Productivity and Increasing Profits in the Shift from Piece Rates to Continuous Flow Production,” *Industrial Relations*, 44, pp. 307-330.

14. Student Presentations (4/26/11)