Economics 282/291: 
Contracts and Organizations

Description

This is focused on the foundations and recent developments in contract theory (also known as incentive theory) and related topics. Part I of the course carefully analyzes the hidden information (adverse selection) principal-agent model and its application to contracts. It covers the simple one agent model, and the multi-agent model using the set-up of mechanism design. Part II is devoted to the theory of Moral Hazard and its applications. Time permitting, part III concentrates on the Theory of the Firm and Incomplete Contracts.

Prerequisites

Economics 202 and 203. Working knowledge of game theory (the level of Economics 286 is not required).

Requirements & Grades

Problem Sets: During the quarter students will be required to hand in 4 problem sets. The problem sets will be distributed on Tuesdays, every 2 weeks, starting on 1/14/03, and will be due IN CLASS 9 days later on Wednesdays. You are strongly encouraged to work in teams, but the product you turn in must be individual work.

Final exam: A final take-home exam will be distributed at the end of the semester which will be due in 24 hours. These should not be done in teams but rather individual work is required.

Final grade: The final grade will consist of 75% problem sets and 25% final exam.

Readings

A set of detailed notes will be made available on the web. There is also a list of articles, those marked with an asterisk are highly recommended, and other articles are supplemental to the material. Most articles are available through JSTOR on the web, or can be found in the library.
Syllabus

I. Hidden Information (Adverse Selection)

I.1 Static Models.


(*) Baron, D. and R. Myerson (1982), "Regulating a Monopolist with Unknown Cost," *Econometrica* 50:911-930


I.2 Mechanism Design and Multiple Agents

The General Mechanism Design Problem: The Revelation Principle

(*) Mas-Colell, A., M. Whinston and J. Green, *Microeconomic Theory*, Oxford University Press (henceforth MWG), Ch. 23 section B

Dominant Strategy Implementation: The Groves-Clarke mechanism
(**) MWG Ch.23 section C


Bayesian Implementation: The Expected Externality (AGV) mechanism

(**) MWG Ch.23 section D


Bayesian Implementation: The Linear Utility Case with Participation Constraints

(**) MWG Ch.23 sections D & E


I.3 Dynamic Models and Renegotiation


III. Moral Hazard (Hidden Action)

III.1 Static One-Agent Models
III.2 Static Multi-Agent Models


III.3 Dynamic Models and Renegotiation


  *Econometrica 59*:1735-1753


III.4 Multi-Task Analysis


IV. Theory of the Firm

IV.1 Established Views of the Firm


IV.2 Incomplete Contracts and Renegotiation


IV.3 Foundations of Incomplete Contracts


(*) Tirole, J. (1995) "Incomplete Contracts: Where do We Stand?," mimeo

IV.4 Alternative approaches


IV.5 The Firm as a Bearer of Reputation

