

Syllabus

MECS 570-1

Organizational Economics I: Organizations and Markets

Fall 2019

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Course Description and Objectives

Most activity in the modern economy takes place within, or is facilitated by, organizations. This is the first course in a two-course sequence in Organizational Economics that focuses on developing and deepening our understanding of firms and other organizations. Our central premise is that organizations are messes but not mysteries: many firm practices can be fruitfully understood as the outcome of strategic interactions among individuals who are faced with internal and external constraints.

This course focuses on theories of incentives, adaptation, and firm boundaries, with the ultimate aim of understanding how firm practices affect and are affected by the broader economy. In addition to covering more recent papers, we will also discuss several classic papers. One goal of the course is that by the end of the quarter, when faced with an empirical phenomenon, you should be able to quickly write down a model to explain it.

To reach this goal, the lectures will focus more on models' key assumptions than on their mechanics. To get more out of the class, you should always have in mind the following questions when we discuss a model. What are the key assumptions of the model that drive its main results? How reasonable are these assumptions? What would happen to the model if these assumptions are modified?

Requirements

There are two deliverables for credit in the course: a model-development essay and the choice between one in-class presentation of a paper from the syllabus or a short write-up of the results in that paper.

The model-development essay should select one aspect from one case (or another source of inspiration) and do three things: first, briefly describe the chosen aspect of the case; second, assess the extent to which existing theory is or is not consistent with this chosen aspect; and, third, briefly sketch the beginnings of a model that would be consistent with this chosen aspect. The model-development essay should be just a short sketch—three to five pages.

Timing

The class will meet on Mondays from 9:00am to 11:45am in KGH 4301.

Course Overview

The course is organized around 5-6 topics. I might still make changes to the topics and readings but the next few pages should give you a pretty good idea of what we will cover in class. The topics are:

Topic 1: Incentives and Communication in Organizations (3 weeks)

Topic 2: Decision Making in Organizations (2 weeks)

Topic 3: Boundaries of the Firm (2-3 weeks)

Topic 4: Organizational Structures and Processes (1-2 weeks)

Topic 5: Competition and Organization (1 week)

Topic 6: Careers in Organizations (1 week)

Topic 1: Incentives and Communication in Organizations

(3 weeks)

Overview

*Gibbons, Robert and John Roberts. 2013. Economic Theories of Incentives in Organizations. In *The Handbook of Organizational Economics*, R. Gibbons and J. Roberts (eds.), Princeton, NJ: Princeton University Press.

Formal Incentive Contracts

Risk-Incentives Trade-off

Holmstrom, Bengt. 1979. Moral Hazard and Observability. *Bell Journal of Economics*, 1(1): 74-91.

Limited Liability

Jewitt, Ian, Ohad Kadan, and Jeroen Swinkels. 2008. Moral Hazard with Bounded Payments. *Journal of Economic Theory*, 143(1): 59-82.

Multiple Tasks and Misaligned Performance Measures

Holmstrom, Bengt and Paul Milgrom. 1991. Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design. *Journal of Law, Economics, and Organization*, 7(Special Issue): 24-52.

Baker, George. 2002. Distortion and Risk in Optimal Incentive Contracts. *Journal of Human Resources*, 37(4): 728-751.

Contracts with Externalities

Segal, Ilya. 1999. Contracting with Externalities. *Quarterly Journal of Economics*, 114(2): 337-388.

No Contracts

Career Concerns

Holmstrom, Bengt. 1999. Managerial Incentive Problems—A Dynamic Perspective. *Review of Economic Studies*, 66(1); 169-182.

Relational Incentive Contracts

*Malcomson, James. 2013. Relational Incentive Contracts. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Topic 2: Decision Making in Organizations (2 weeks)

Overview

*Gibbons, Robert, Niko Matouschek, and John Roberts. 2013. Decisions in Organizations. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Topics

Authority

Aghion, Philippe and Jean Tirole. 1997. Formal and Real Authority in Organizations. *Journal of Political Economy*, 105(1): 1-29.

Dessein, Wouter. 2002. Authority and Communication in Organizations. *Review of Economic Studies*, 69(4): 811-838.

Delegation

Alonso, Ricardo and Niko Matouschek. 2008. Optimal Delegation. *Review of Economic Studies*, 75(1): 259-293.

Hierarchies

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

Topic 3: Boundaries of the Firm (2-3 weeks)

Overview

*Gibbons, Robert. 2005. Four Formal(izable) Theories of the Firm? *Journal of Economic Behavior and Organization*, 58(2): 200-245.

Papers

Transaction Cost Economics

Tadelis, Steven and Oliver Williamson. 2013. Transaction Cost Economics. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Property Rights

Hart, Oliver. 1995. *Firms, Contracts, and Financial Structure*. New York: Oxford University Press (Chapter 2).

Incentive Systems

Holmstrom, Bengt and Paul Milgrom. 1994. The Firm as an Incentive System. *American Economic Review*, 84(4): 972-991.

Influence Activities

Powell, Michael. 2015. An Influence-Cost Model of Organizational Practices and Firm Boundaries. *Journal of Law, Economics, and Organization*, 31(suppl 1): i104-i142.

Empirical Evidence

Monteverde, Kirk and David Teece. 1982. Supplier Switching Costs and Vertical Integration in the Automobile Industry. *Bell Journal of Economics*, 13(1): 206-213.

Forbes, Silke and Mara Lederman. 2009. Adaptation and Vertical Integration in the Airline Industry. *American Economic Review*, 99(5): 1831-1849.

Baker, George and Thomas Hubbard. 2003. Make versus Buy in Trucking: Asset Ownership, Job Design, and Information. *American Economic Review*, 93(3): 551-572.

Foundations

Maskin, Eric and Jean Tirole. 1999. Unforeseen Contingencies and Incomplete Contracts. *Review of Economic Studies*, 66(1): 83-114.

Aghion, Philippe, Drew Fudenberg, Richard Holden, Takashi Kunimoto, and Olivier Tercieux. 2012. Subgame Perfect Implementation Under Information Perturbations. *Quarterly Journal of Economics*, 127(4): 1843-1884.

Fehr, Ernst, Michael Powell, and Tom Wilkening. 2018. Behavioral Constraints on the Design of Subgame-Perfect Implementation Mechanisms. *Working Paper*.

Topic 4: Organizational Structures and Processes (1-2 weeks)

Overview

Garicano, Luis and Timothy Van Zandt. 2013. Hierarchies and the Division of Labor. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Structures

Dessein, Wouter and Tano Santos. 2006. Adaptive Organizations. *Journal of Political Economy*, 114(5): 956-995.

Alonso, Ricardo, Wouter Dessein, and Niko Matouschek. 2008. When Does Coordination Require Centralization? *American Economic Review*, 98(1): 145-179.

Rantakari, Heikki. 2008. Governing Adaptation. *Review of Economic Studies*, 75: 1257-1285.

Hierarchies

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

Garicano, Luis and Esteban Rossi-Hansberg. 2006. Organization and Inequality in a Knowledge Economy. *Quarterly Journal of Economics*, 121(4): 1383-1435.

Hart, Oliver and John Moore. 2005. On the Design of Hierarchies: Coordination versus Specialization. *Journal of Political Economy*, 113(4): 675-702.

Topic 5: Competition and Organization (1 week)

Overview

Leibenstein, Harvey. 1966. Allocative Efficiency vs. 'X-Efficiency'. *The American Economic Review*, 56(3): 392-415.

Theories

Competition and Incentives

Raith, Michael. 2003. Competition, Risk, and Managerial Incentives. *American Economic Review*, 93(4): 1425-1436.

Information and Firm Organization

Gibbons, Robert, Richard Holden, and Michael Powell. 2012. Organization and Information: Firms' Governance Choices in Rational-Expectations Equilibrium. *Quarterly Journal of Economics*, 127(4): 1813-1841.

Price Levels and Firm Organization

Legros, Patrick and Andrew Newman. 2013. A Price Theory of Vertical and Lateral Integration. *Quarterly Journal of Economics*, 128(2): 725-770.

Competitive Rents and Firm Productivity

Powell, Michael. Forthcoming. Productivity and Credibility in Industry Equilibrium. *RAND Journal of Economics*.

Topic 6: Careers in Organizations (1 week)

Overview

*Waldman, Michael. 2013. Theory and Evidence in Internal Labor Markets. In *The Handbook of Organizational Economics*, eds. Robert Gibbons and John Roberts. Princeton, NJ: Princeton University Press.

Papers

Internal Labor Markets

Waldman, Michael. 1984. Job Assignments, Signalling, and Efficiency. *RAND Journal of Economics*, 15(2): 255-267.

Baker, George, Michael Gibbs, and Bengt Holmstrom. 1994. The Internal Economics of the Firm: Evidence from Personnel Data. *Quarterly Journal of Economics*, 109(4): 881-919.

Gibbons, Robert and Michael Waldman. 1999. A Theory of Wage and Promotion Dynamics Inside Firms. *Quarterly Journal of Economics*, 114(4): 1321-1358.

Personnel Policies

Lazear, Edward. 1979. Why is there Mandatory Retirement? *Journal of Political Economy*, 87(6): 1261-1284.

Ke, Rongzhu, Jin Li, and Michael Powell. 2018. Managing Careers in Organizations. *Journal of Labor Economics*, 36(1): 197-252.

Potential Papers for In-Class Presentations

More will be added

Incentives and Communication in Organizations

Angelucci, Charles. 2017. Motivating Agents to Acquire Information. *Working Paper*.

Breza, Emily, Supreet Kaur, and Yogita Shamdasani. 2018. The Morale Effects of Pay Inequality. *Quarterly Journal of Economics*, 2(1): 611-663.

Carroll, Gabriel. 2015. Robustness and Linear Contracts. *American Economic Review*, 105(2): 536-563.

Cisternas, Gonzalo. 2018. Two-Sided Learning and the Ratchet Principle. *Review of Economic Studies*, 85: 307-351.

Ederer, Florian, Richard Holden, and Margaret Meyer. 2018. Gaming and Strategic Opacity in Incentive Provision. *Rand Journal of Economics*, 49(4): 819-854.

Letina, Igor, Shuo Liu, and Nick Netzer. 2018. Delegating Performance Evaluation. *Working Paper*.

Lipnowski, Elliot and Doron Ravid. 2019. Cheap Talk with Transparent Motives. *Working Paper*.

Decision Making in Organizations

Bonatti, Alessandro and Heikki Rantakari. 2016. The Politics of Compromise. *American Economic Review*, 106(2): 225-259.

Deimen, Inga and Dezso Szalay. Forthcoming. Delegated Expertise, Authority, and Communication. *American Economic Review*, 109(4): 1349-1374.

Dessein, Wouter and Richard Holden. 2019. Organizations with Power-Hungry Agents. *Working Paper*.

Frankel, Alexander. 2014. Aligned Delegation. *American Economic Review*, 104: 66-83.

Halac, Marina and Pierre Yared. 2019. Commitment vs. Flexibility with Costly Verification. *Working Paper*.

Kolotilin, Anton. 2019. Persuasion Meets Delegation. *Working Paper*.

Lo, Desmond, Wouter Dessein, Mrinal Ghosh, and Francine Lafontaine. 2016. Price Delegation and Performance Pay: Evidence from Industrial Sales Forces. *Journal of Law, Economics, and Organization*, 32(3): 508-544.

Rantakari, Heikki. 2012. Employee Initiative and Managerial Control. *American Economic Journal: Microeconomics*, 4(3): 171-211.

Boundaries of the Firm

Baliga, Sandeep and Tomas Sjostrom. 2018. A Theory of the Firm based on Hagglng, Coordination, and Rent-Seeking. *Working Paper*.

Braguinsky, Serguey, Atsushi Ohyama, Tetsuji Okazaki, and Chad Syverson. 2015. Acquisitions, Productivity, and Profitability: Evidence from the Japanese Cotton Spinning Industry. *American Economic Review*, 105(7): 2086-2119.

Cunningham, Colleen, Florian Ederer, and Song Ma. 2019. Killer Acquisitions. *Working Paper*.

Macchiavello, Rocco and Pepita Miquel-Florensa. 2018. Vertical Integration and Inter-Firm Relationships: Evidence from the Costa Rica Coffee Chain. *Working Paper*.

Van den Steen, Eric. 2010. Interpersonal Authority in a Theory of the Firm. *American Economic Review*, 100(1): 466-490.

Competition and Organization

Alfaro, Laura, Paola Conconi, Harald Fadinger, and Andrew Newman. 2016. Do Prices Determine Vertical Integration? *Review of Economic Studies*, 83(3): 855-888.

Backus, Matt. 2019. Why is Productivity Correlated with Competition? *Working Paper*.

Board, Simon, Moritz Meyer-ter-Vehn, and Tomasz Sadzik. 2019. Recruiting Talent. *Working Paper*.

Ishiguro, Shingo. 2016. Relationships and Growth: On the Dynamic Interplay between Relational Contracts and Competitive Markets in Economic Development. *Review of Economic Studies*, 83(2): 629-657.

Careers in Organizations

Alonso, Ricardo. 2018. Recruiting and Selecting for Fit. *Working Paper*.

Benson, Alan, Danielle Li, and Kelly Shue. 2019. Promotions and the Peter Principle. *Quarterly Journal of Economics*, 134(4): 2085-2134.

Burks, Stephen, Bo Cowgill, Mitchell Hoffman, and Michael Housman. 2015. The Value of Hiring through Employee Referrals. *Quarterly Journal of Economics*, 130(2): 805-839.

Cowgill, Bo. 2015. Competition and Productivity in Employee Promotion Contests. *Working Paper*.

Deserrano, Erika. 2019. Financial Incentives as Signals: Experimental Evidence from the Recruitment of Village Promoters in Uganda. *American Economic Journal: Applied Economics*, 11(1): 277-317.

Frankel, Alexander. 2019. Selecting Applicants. *Working Paper*.

Hoffman, Mitchell, Danielle Li, and Lisa Kahn. 2018. Discretion in Hiring. *Quarterly Journal of Economics*, 133(2): 765-800.

Pallais, Amanda, Emily Glassberg Sands. 2016. Why the Referential Treatment? Evidence from Field Experiments on Referrals. *Journal of Political Economy*, 124(6): 1793-1828.