

The Central University of Finance and Economics China Center for Human Capital and Labor Market Research

Industrial Organization

Fall 2012

Instructor: Sophie Wang
Email: sophiewang2004@gmail.com
Class hours & place: 1:30 pm – 3:20 pm, Monday; Main Building 115
10:10 am – 12:00 pm, Wednesday; Main Building 112
Office hours & place: 8:15 am – 11:15 am, Thursday; Academic Hall #613

Course Outline

Course Summary and Objectives:

The goal of this course is to analyze the contractual relationships of economic agents. The first part of the course introduces principal-agent theory - Moral Hazard and Adverse Selection. In a second part, we will in some detail discuss the economic concept of ‘ownership’. The paradigm of ‘incomplete contracting’ will turn out to be an important building block for ownership-based theory of the firm. We will study the foundation of incomplete contracting, and discuss a variety of applications to issues such as privatization, human capital formation, hierarchies, and corporate finance.

Textbooks:

There is no required textbook, as no single textbook covers the variety of material we discuss in class. Useful books are

- Tirole, Jean (1988): The Theory of Industrial Organization, MIT Press (esp. ch. 0 for a brief overview of the theory of the firm).
- Mas-Colell, A., Whinston, Michael D. and Jerry R. Green (1995): Microeconomic Theory, Oxford University Press (ch. 14 on Moral Hazard)
- Salanie, Bernard (1998): The Economics of Contracts - A Primer, MIT Press. (especially chs. 2, 3 on Adverse Selection, and ch. 5 on Moral Hazard),
- Laffont, J.-J. and Martimort (2001): The Theory of Incentives: The Principal-Agent Problem, Princeton University Press.
- Bolton, P. and M. Dewatripont (2005): Contract Theory, MIT Press.
- Hart, Oliver (1995): Firms, Contracts and Financial Structure, Oxford, UK, Oxford University Press, (Chs 1-4 of the book are about property-rights theory and incomplete contracts, chs. 5-6 on financial contracting).

Grading:

Midterm	30%
Assignments	30%
Final exam	40%

The approximate final grade distribution for the course will be as follows. Adjustments will be made as necessary. A: 90% and above; B: 80%-89%; C: 70%-79%; D: 60%-69%; F: below 60%.

Outline and Reading:

Ch. 1: Agency Theory: Moral Hazard and Adverse Selection

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

Grossman, S. and O. Hart (1983): "An Analysis of the Principal-Agent Problem", *Econometrica* 51, 7-45.

Holmstrom, B. (1982): "Moral Hazard in Teams", *Bell Journal of Economics* 13, 324-340.

Holmstrom, B. and P. Milgrom (1991): "Multi-Task Principal-Agent Analyses", *Journal of Law, Economics & Organization* 7, 24-52.

Innes, R. (1990): "Limited Liability and Incentive Contracting with Ex-ante Action Choices", *Journal of Economic Theory* 52, 45-67.

Rogerson, W. (1985): "Repeated Moral Hazard", *Econometrica* 53, 69-76.

Ch. 2: Ownership and Property Rights Theories

Aghion, P. and J. Tirole (1994): "The Management of Innovation", *Quarterly Journal of Economics* 102, 1185-1209.

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

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

Grossman, S. and O. Hart (1986): "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration", *Journal of Political Economy* 94, 691-719.

Hart, O. (1995): *Firms, Contracts and Financial Structure*, Oxford, UK, Oxford University Press, (ch.1-3).

Hart, O. and B. Holmstrom (2009): "A Theory of Firm Scope," *Quarterly Journal of Economics*.

Hart, O. and J. Moore (1990): "Property Rights and the Nature of the Firm", *Journal of Political Economy* 98, 1119-1158.

Hart, O. and J. Moore (2007): "Incomplete Contracts and Ownership: Some new Thoughts", *American Economic Review* 98(2).

Ch. 3: Optimal Incomplete Contracts and Applications

Bolton, P. and D. Scharfstein (1990): "A Theory of Predation Based on Agency Problems in Financial Contracting", *American Economic Review* 80, 93-106.

Che, Y.-K. and D. Hausch (1999): "Cooperative Investments and the Value of Contracting", *American Economic Review* 90, 125-147.

Edlin, A. and S. Reichelstein (1995): "Holdups, Standard Breach Remedies, and Optimal Investment", *American Economic Review* 86, 478-501.

Evans, R. (2008): "Simple Efficient Contracts in Complex Environments," *Econometrica* 76(3), 459-491.

Fehr, E., Hart, O., and C. Zehnder (2009): "Contracts as Reference Points-Experimental Evidence," forthcoming American Economic Review.

Hart, O. (2009): "Hold-up, Asset Ownership, and Reference Points," Quarterly Journal of Economics, 124(1), 267-300.

Hart, O. and J. Moore (1999): "Foundations of Incomplete Contracts", Review of Economic Studies 66, 115-138.

Hart, O. and J. Moore (2008): "Contracts as Reference Points", Quarterly Journal of Economics, 123(1), 1-48.

Kessler, A.S. and Lulfesmann, C. (2005): "Wealth Constraints and Option Contracts in Models with Sequential Investments" , Economic Journal 36, 753-770.

Lulfesmann, C. (2005): "Wealth Constraints and Option Contracts in Models with Sequential Investments" , RAND Journal of Economics 36, 753-770.

MacLeod, W. and J. Malcomson (1993): "Investments, Hold Up and the Form of Market Contract" , American Economic Review 83, 811-837.

Maskin, E. (2002): "On Indescribable Contingencies and Incomplete Contracts" , European Economic Review 46, 725-733.

Noldeke, G. and K. Schmidt (1998): "Sequential Investments and Options to Own" , RAND Journal of Economics 29, 633-653.

Ohlendorf, S. (2009): "Expectation Damages, Divisible Contracts, and Bilateral Investment," American Economic Review, 99(4), September, 1608-1618.

Watson, J. (2007): "Contract, Mechanism Design, and Technological Detail," Econometrica 75, 55-81.