

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

## **Industrial Organization**

**Spring 2014**

<u>Instructor:</u>	Fang Xia
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<u>Class hours &amp; place:</u>	1:30 pm-3:20 pm, Tuesday and Thursday; Main Building #471
<u>Office hours &amp; place:</u>	10:30 am-12:00 pm, Tuesday and Thursday; Academic Hall #609

## **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:**

Hart, Oliver (1995): Firms, Contracts and Financial Structure, Oxford, UK, Oxford University Press.

### **Grading:**

Home works (two)	10%
Presentations (two)	40%
Midterm	20%
Final exam	30%

## **Outline and Reading:**

### **Part I 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.

### **Part II 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).

### **Part III 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.