

## MECS 449-2: Economics of Organization

Spring 2011  
Th 9-12  
Leverone 619

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### Overview:

This course provides an introduction to the Economics of Organization. We will discuss the classic papers and some recent research in organizational economics. The purpose of covering these papers is to help you build up your toolbox as an applied researcher. One goal is that by the end of the class, when faced with an empirical phenomenon, you can quickly write down a model to explain it by using or extending the models covered.

To reach this goal, we will focus the lecture more on the model's key assumptions than its mechanics. (Of course, you should make sure to have read the paper and understand the details of the model yourself!) This will help you better understand the applicabilities of the models. To get more out of the class, you should ask yourself what are the key assumptions of the model? How reasonable are these assumptions? What will happen to the model when these assumptions are modified? Thinking through these questions help you identify future research questions and transform from a class-taker to a scholar.

The topics of the class are roughly organized into the following modules:

- Module 1: Static, Explicit Contracts (Week 1-2)
- Module 2: Dynamic and Relational Contracts (Week 3-5)
- Module 3: Information and Matching (Week 6-9)

### Requirements

Each class session will cover two to three journal articles. To make sure you have read them, you are expected to come to class with a **one-page write-up** of one of the articles required for that day. An article write-up should cover the paper's main motivation and results. You are also encouraged to write down your extra thoughts of the paper: its strength and weakness, possible extensions of the model, alternative models that can explain similar phenomenon (and empirical tests to sort them out).

You are also required to submit a 10-15 pp. paper by Monday of examination week. This paper is on the topic of your choice. Use this paper to get started on your own research agenda. At a minimum, it should contain a clear statement of your research question(s), why it is important, and how you intend to go about answering it. You should then use the rest of the paper to summarize what the existing literature has to say about your research question and describe the data or theory you intend to apply. This does not have to be a complete paper (although if it is, that is wonderful). But it should be focused enough so that it provides you a strong foundation from which to build.

We will require a 2-3 page abstract of your paper midway through the course (4/28). You are welcome (and encouraged) to discuss with me about your ideas earlier. Finally, you will give a presentation on 6/2 about a paper of your choice. A suggested list is included at the end of the syllabus.

Your grades will be based 50% on your paper and 50% on your performance in class.

### **Week 1: Static Contracts: Single Agent (3/31)**

\*Holmstrom, Bengt (1979). "Moral Hazard and Observability," *Bell Journal of Economics*, 13(2), 324-340.

\*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.

\*Prendergast, Canice (2002). "The Tenuous Trade-Off between Risk and Incentives." *Journal of Political Economy*, 2002, 110(5), pp. 1071-102.

\*MacLeod, Bentley (2003). W. Bentley MacLeod, 2003. "[Optimal Contracting with Subjective Evaluation](#)," [American Economic Review](#), vol. 93(1), pages 216-240.

### **Week 2: Static Contracts: Multiple Agents (4/7)**

\*Holmstrom, Bengt (1982) "Moral Hazard in Teams" *The Bell Journal of Economics*, Vol. 13, No. 2, pp. 324-340

\*Itoh, H. "Incentives to Help in Multi-Agent Situations." *Econometrica* 59 (1991): 611-36.

\*Lazear, Edward P & Rosen, Sherwin, 1981. "[Rank-Order Tournaments as Optimum Labor Contracts](#)," [Journal of Political Economy](#), Vol. 89(5), pp. 841-64, October

### **Week 3: Dynamic Contracts and Recursive Representation (4/14)**

\*Rogerson, Bill, "Repeated Moral Hazard." *Econometrica*, Vol. 53 No.1 (Jan, 1985), pp.69-76.

\*Fudenberg, Drew, Bengt, Holmstrom, and Paul Milgrom, "Short-term Contracts and Long-term Agency Relationship." *Journal of Economic Theory*, Vol 51, No.1 (June, 1990), pp.1-31.

\* Levin, Jon. "Relational Incentive Contracts," *American Economic Review*, (2003) 93(3), pp. 835-847

### **Week 4: Dynamics in Relational Contracts (4/21)**

\*Thomas and Worrall. "Self-enforcing Wage Contracts." *Review of Economic Studies*, 55(4), (1988) pp.541-553.

\*Fong and Li "Relational Contracts, Efficiency Wages, and Employment Dynamics." (2010), mimeo.

\*Li and Matouschek "The Burden of Past Promises" (2011), mimeo.

### **Week 5: Relational Contracts: Additional Topics (4/28)**

\*Baker, George, Robert Gibbons, and Kevin J. Murphy. (1994). "Subjective Performance Measures in Optimal Incentive Contracts." *Quarterly Journal of Economics* 109:1125-56.

\* Rayo, Luis (2007). "Relational Incentives and Moral Hazard in Teams." *Review of Economic Studies*, 74(3), pp. 937-963.

\*Abreu, Milgrom, Pearce (1992). "Information and Timing in Repeated Partnership" *Econometrica*, 59(6), 1713-1733.

\*Fuchs (2007). "Contracting with Repeated Moral Hazard and Private Evaluations," *American Economic Review*, 97(4), 1432-1448.

\*Fong and Li (2009). "Information and Intertemporal Signal Garbling in Relational Contracts," Mimeo

### **Week 6: Learning (5/4)**

DeGroot: Optimal Statistical Decisions, Chapter 9

Harris, Milton and Holstrom, Bengt, (1982). "A Theory of Wage Dynamcis," *Review of Economic Studies*, 49(3), 315-33.

Beaudry Paul, and John DiNardo (1991). "The Effect of Implicit Contracts on the Movement of Wages Over the Business Cycle: Evidence from Micro Data, 99 (4), pp/ 665-688

Chiappori, Pierre, Bernard Salanie, and Julie Valentin (1999). "Early Beginners vs Late Starters" 107 (4), pp. 731-760

### **Week 7: Career Concern (5/11)**

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

\*Dewatripont, M.; Jewitt, I.; and Tirole, J. "The Economics of Career Concerns, Part II: Applications to Missions and Government Agencies." *Review of Economic Studies* 66 (1999): 199-217.

\*Prendergast (1993). "[A Theory of 'Yes Men'](#)," *American Economic Review* 83(4), 757-770.

\*Zwiebel, Jeffrey (1995). "Corporate Conservatism and Relative Compensation." *Journal of Political Economy* 103 (1), pp. 1-25.

### **Week 8: Matching (5/18)**

\*Michael Kremer : "The O-Ring Theory of Economic Development," *Quarterly Journal of Economics*, August, 1993

\*Li, Jin (2010). "A Theory of Wage Dynamics and the Wage Distribution with Assignment and Pareto Learning." Mimeo.

\*Sherwin Rosen, 1982. "[Authority, Control, and the Distribution of Earnings](#)," *Bell Journal of Economics*, The RAND Corporation, vol. 13(2), pages 311-323

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

### **Week 9: Asymmetric Information and Training (5/25)**

\*Greenwald: "Adverse Selection in the Labor Market," *Review of Economic Studies*, June 1986.

\*Gibbons, Robert and Lawrence Katz: "[Layoffs and Lemons](#)" *Journal of Labor Economics*, 9 (1991): 351-80.

\*Michael Waldman, 1984. "[Job Assignments, Signalling, and Efficiency](#)," [RAND Journal of Economics](#), The RAND Corporation, vol. 15(2), pages 255-267

\*Acemoglu and Pischke, "[The Structure of Wages and Investment in General Training](#)" June 1999, *Journal of Political Economy*, volume 107, pp. 539-572.

\*David Autor, "[Why do Temporary Help Firms Provide Free General Skills Training?](#)" *Quarterly Journal of Economics*, 116 (4), November 2001, 1409-1448.

### **Week 10: Student Presentation (6/2)**

Spear and Srivastava, "On Repeated Moral Hazard with Discounting." *Review of Economic Studies* (Oct, 1987), Vol. 54, No. 4, pp. 599–617.

Clementi, Gian Luca and Hugo Hopenhayn, "A Theory of Financing Constraints and Firm Dynamics" *Quarterly Journal of Economics* Vol 121, No 1, (Feb 2006), pp 229-265.

Che, Yeon-Koo, and Seung-Weon Yoo. 2001. "Optimal Incentives for Teams." *American Economic Review* 91: 525-41.

Jon Levin, "Multilateral Contracting and the Employment Relationship," *Quarterly Journal of Economics*, 117(3), August 2002

Chassang (Forthcoming AER). "Building Routines: Learning, Cooperation, and the Dynamics of Incomplete Relational Contracts."

Halac (2008). "Relational Contracts and the Value of Relationships." Mimeo.

Prendergast, Canice and Lars Stole (1996). "[Impetuous Youngsters and Jaded Old-Timers: Acquiring a Reputation for Learning](#)," *Journal of Political Economy* 104(6), 1105-1134.

Prendergast, Canice (2009) "[Contracts and Conflict in Organizations](#)," mimeo.

Scharfstein, David S & Stein, Jeremy (1990). "[Herd Behavior and Investment](#)," [American Economic Review](#), vol. 80(3), pages 465-79,

Harris, Milton & Weiss, Yoram, 1984. "[Job Matching with Finite Horizon and Risk Aversion](#)," [Journal of Political Economy](#), University of Chicago Press, vol. 92(4), pages 758-79.

Lucas (1978): [On the Size Distribution of Business Firms](#) *Bell Journal of Economics*, 1978, **9**, (2), 508-523