Economics 654, Spring, 1999

Economic and Financial Institutions: Structure and Purpose

Professor: Shira Lewin

Class meets Tu/Th 12:40 - 2:00 PM
Office: Heady 471 (294-6292) or home office (515-255-8348)
Email: slewin@iastate.edu
Office Hours: Tu/Th 11:00 - 11:30 AM, 2:00 - 3:00 PM
Secretary: Pam Mundt, Heady 460, 294-7318
Prerequisite: Understanding of perfect Bayesian equilibrium.

Requirements (tentative):

5 Problem sets (18%).
Class participation (17%).
2 take-home tests on the basic theory covered (17%).
2 short papers analyzing and evaluating the course readings (17%).
2 creative assignments. In the first, evaluate 2-3 articles on a topic and pose questions. In the second, create your own preliminary model to answer a question. (31%)

If you are not taking the course for credit, you are not responsible for exams and need not hand in problem sets (if you don’t do them, you won’t learn anything).
However, you must participate in class discussions, do most of the ** readings and do your share of class presentations. Passive auditing is not permitted.

You are required to do (**) readings and are encouraged to do (*) readings.
You cannot get an A in this course without doing the reading and participating actively in class.

Guide to Course Readings

The syllabus below is tentative. Some readings may be added or removed.
All starred readings are in the packet or a reader.

** The reading is extremely important and is required.
* The reading is recommended but not required.

A course packet will be available from CopyCat. 303 Welch Ave. 292-8096.

Most items on the reading list (even many which are unstarred) are either in a journal in the Econ/Soc reading room or on reserve.
Items for late in the semester will go on reserve before you need them.
Papers that are not in the library (unpublished, etc.), especially, are on reserve.
Texts:


You should already own this. If you don’t have it, buy it now. We will use only a couple of chapters, but the book is an essential reference manual which you will use again and again.


Note: Most readings in this book are abridged. This enables you to get a taste of many papers with a limited time investment. You can look up the full version of papers that you find particularly interesting. In some cases, the abridgement is excessive. In these cases, a full version is in the packet.


This is a large reader, and we will be using only about a third of it, but it’s cheap for its size, and full of classics. All articles are unabridged.

Employment Relationships and Agency Problems (5 lectures)

Two problem sets. One take-home test at the end.

Text Readings

** MWG Chapter 14 (includes hidden action, hidden information, revelation principle)


Principal-Agent Model and Moral Hazard


Explanations of the Employment Relationship


Other Papers

(how extremely high penalties can achieve the first-best outcome without wealth constraints)

Transaction Costs: Markets vs. Firms (2 lectures)

The Real Role of the Market

(Read the full version, provided in the packet. This paper is excessively abridged in P&K.)

The Nature of the Firm

(selection is P&K ch. 3)
** Coase, R. H. 1937. The nature of the firm. *Economica*. November. (P&K ch. 7 or Williamson ch. 1)
**Vertical Integration** (3 lectures)

One short paper on this and the previous section.

**The Market as an Enforcement Mechanism**

  *J Pol Econ* 89(4): 615-41.  Ch. 15 in Williamson.

**When Markets Fail**


Goldberg, V.  Relational exchange: economics and complex contracts.  Selection is chapter 5 in P&K.


** Pitfalls of Vertical Integration**


Eccles, R. G.  Transfer pricing as a problem of agency.  In J. W. Pratt & R. J. Zeckhauser (eds.),  
  *Principals and Agents: The Structure of Business.*  Boston: Harvard University Press, 19??.


The Property Rights Approach (6.5 lectures)

Two problem sets and one take-home test on this and the following section.

**Introduction**

** MWG, Section 22.E (Nash bargaining).

Hart, chapter 1.
** Hart, chapter 2.

**Optimal Control Rights With Renegotiation**

** MWG, Section 22.F (Shapley value).
** Hart, chapter 3.

**Foundations of Incomplete Contracting Models**

** Hart, chapter 4.

**Other Papers**

Formal vs. Informal Contracts and Control Rights (2.5 lectures)


For more papers, see "Reputation and Trust" below.

Agriculture (2 lectures)

Industrialization of Agriculture


**Tenancy Arrangements**


**Financial Structure (5 lectures)**

One problem set.  First creative assignment due about now.

**Debt**

** Hart, chapter 5.**


**Debt vs. Equity**


* Hart, chapter 6.


**Corporate Governance**


** Hart, chapter 8.


See also chapters 21-25 in P&K (all short) for some other perspectives.

**Perspectives and Challenges** (4 lectures)

One short paper.  Second creative assignment comes due.

**Perspectives on the Literature and the Current State of Theory**

** Putterman, L., and Krozner, R. S.  The economic nature of the firm: A new introduction.  In P&K, pp. 8-31 (start with section “What is a firm?”).  Bring your questions to class.


**Institutional Arguments**


**Understanding Power: The Interdependence of Efficiency and Distribution**

** Bowles, S., and Gintis, H. Contested exchange: New microfoundations for the political economy of capitalism. Selection is chapter 15 in P&K.

**Beyond Markets and Hierarchies**

* Akerlof, G. Labor contracts as partial gift exchange. Selection is chapter 19 in P&K.
Richardson, G. B. The organization of industry. Selection is chapter 10 in P&K.
Ask me about other references on network forms of organization.
Other Topics (not covered)

Franchising

Risk Sharing and Insurance

Reputation and Trust
See Otsuka et al 1992 for more references (section IV.A).
Clans and Japanese Firms


Bankruptcy

Hart, chapter 8. (See here for more references.)

Public vs. Private Ownership

**Theory of Regulation**


**Torts and Allocation of Liability**


**Cooperatives and Group Incentives**


**Innovation**
