

Organizational Economics

European University Institute

Block IV — April-May 2021

Instructor Information

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Assessment

In-class presentations: 20%
Take home Exam: 80%

Course Description

This course is intended to introduce you to various topics in Organizational Economics with the goal of developing a deeper understanding of incentives and organisation in economics, and their influence on economic activity. The course intends to provide you with conceptual and theoretical frameworks that have wide applicability, with an eye toward applying these frameworks to understand observable phenomena, guide strategy and inform policy.

We start by reviewing agency theories of organisational economics (Incentive contracts, Relational contracts and Career Concerns). We then move to study within firm's organisation. We start with a study of decision making in organisations (Team Formation Theories, Authority and Power etc.). We then proceed to a study of employment in organisations (Pay for Performance, Feedback and Communication etc.). Finally we will look at structures and processes in organizations (Models of hierarchy, Delegation etc.). Along with lecture notes, there is two recommended textbooks to obtain an overview of the topic and there is further references for each section. The references are divided into four sections that roughly correspond to what I very optimistically hope to cover in the lectures.

Requirements

Students are required to have in-class presentations of papers from the syllabus and to discuss papers presented in the class by others. A separate list of papers from which students can choose the papers will be uploaded. Students can also suggest papers for their presentation but I will have to approve it. The presentation will have 20% weight in the final assessment. There will be a take-home final exam worth 80% of your grade.

Readings

1. Lecture Notes on Organizational Economics

2. **Recommended Textbook:**

- *Gibbons, Robert, and John Roberts, eds. 2012. "The Handbook of Organizational Economics," Princeton; Oxford: Princeton University Press, .*
- *Bolton Patrick and Mathias Dewatripont, 2005. "Contract Theory," MIT Press Books, The MIT Press, edition 1*

3. Topic papers

Topics

The course is organized around 3-4 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:

1. Agency Theories in Organizational Economics (2 weeks)
 - Formal incentive contracts
 - Relational contracts
 - Career concerns
2. Decision Making in Organisations (2 weeks)
 - Theory of teams
 - Authority and power
 - Influence and culture in organisations
 - Leadership
3. Structure and Process in Organisation (1-2 weeks)
 - Models of Hierarchy
 - Delegation
 - Organizational Design
4. Employment in Organizations¹ (1-2 weeks)
 - Careers in organizations
 - Pay for performance
 - Communication and Feedback in organisations

¹If time allows

Agency Theories in Organisational Economics

*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

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

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

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.

Relational Contracts

Fuchs, William. 2007. "Contracting with Repeated Moral Hazard and Private Evaluations." *American Economic Review* 97: 1432-48.

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

*Gibbons R., Notes on Relational Contracts, MIT.

Baker G., Gibbons R. and Murphy K. (2002), "Relational Contracts and the Theory of the Firm", *Quarterly Journal of Economics*, 117: 39-84.

Career Concerns

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

Meyer, Margaret and John Vickers. 1997. "Performance Comparisons and Dynamic Incentives."

Journal of Political Economy 105: 547-581.

Dewatripont, Mathias, Ian Jewitt and Jean Tirole. 1999. "The Economics of Career Concerns, Part I: Comparing Information Structures." *The Review of Economic Studies* 66: 183-98.

Dewatripont, Mathias, Ian Jewitt and Jean Tirole. 1999. "The Economics of Career Concerns, Part II: Application to Missions and Accountability of Government Agencies." *The Review of Economic Studies* 66: 199-217.

Prendergast, Canice. 2009. "Contracts and Conflict in Organizations." Unpublished manuscript, University of Chicago.

Decision Making in Organisations

*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.

Theory of Teams

Marschak, Jacob and Roy Radner. 1972. *Economic Theory of Teams*. New Haven, CT: Yale University Press.

Radner, Roy. 1972. "Teams" in C.B McGwire and R. Radner (eds) *Decision Making and Organization*.

Sah, Raj and Joseph Stiglitz. 1986. "The Architecture of Economic Systems: Hierarchies and Pol-yarchies." *American Economic Review* 76:716-27.

Cohen, Michael, James March, and Johan Olsen. 1972. "A Garbage Can Model of Organizational Choice." *Administrative Science Quarterly* 17:1-25.

Feldman, Martha and James March. 1981. "Information in Organizations as Signal and Symbol." *Administrative Science Quarterly* 26:171-86.

Authority and Power

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.

Baker, George, Robert Gibbons, and Kevin J. Murphy. 1999. "Informal Authority in Organizations." *Journal of Law, Economics, and Organization* 15: 56-73.

Rotemberg, Julio. 1993. "Power in Profit-Maximizing Organizations." *Journal of Economics & Management Strategy* 2:165-98.

Rajan, Raghuram and Luigi Zingales. 1998. "Power in a Theory of the Firm." *Quarterly Journal of Economics* 113: 387-432.

Van den Steen, Eric. 2009. "Disagreement and the Allocation of Control." Forthcoming, *Journal of Law, Economics, and Organization*.

Influence and Culture in organisations

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

Milgrom, Paul and John Roberts. 1988. "An Economic Approach to Influence Activities in Organizations." *American Journal of Sociology* 94: S154-S179.

Dewatripont, Mathias and Jean Tirole. 2005. "Modes of Communication." *Journal of Political Economy* 113: 1217-38.

Kreps, David. 1990. "Corporate Culture and Economic Theory." In J. Alt and K. Shepsle, eds. *Perspectives on Positive Political Economy*. Cambridge University Press.

Crémer, Jacques. 1993. "Corporate Culture and Shared Knowledge." *Industrial and Corporate Change* 2:351-86.

Leadership

Hermalin, Benjamin. 1998. "Toward an Economic Theory of Leadership: Leading By Example." *American Economic Review* 88: 1188-1206.

Caillaud, Bernard and Jean Tirole. 2007. "Consensus Building: How to Persuade a Group." *American Economic Review* 97: 1877-1900.

Structure and Process in Organisation

*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.

Mookherjee, Dilip. 2012. "Incentives in Hierarchies." Forthcoming in R. Gibbons and J. Roberts (eds.), *The Handbook of Organizational Economics*. Princeton, NJ: Princeton University Press.

Models of Hierarchy

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.

Delegation

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

Mookherjee, Dilip. 2006. "Decentralization, Hierarchies, and Incentives: A Mechanism Design Perspective." *Journal of Economic Literature* 44: 367-90.

Alonso, Ricardo and Niko Matouschek. 2007. "Relational Delegation." *Rand Journal of Economics* 38: 1070-89.

Acemoglu, Daron, Philippe Aghion, Claire Lelarge, John Van Reenen, and Fabrizio Zilibotti. 2007. "Technology, Information and the Decentralization of the Firm." *Quarterly Journal of Economics* 122: 1758-99.

Organizational Design

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.

Employment in Organizations

*Gibbons, Robert and Michael Waldman. 1999. "Careers in Organizations: Theory and Evidence." Chapter 36 in Volume 3B of O. Ashenfelter and D. Card (eds.), *Handbook of Labor Economics*, North Holland.

Careers in Organisations

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.

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.

Pay for performance

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

Lazear, Edward. 2000. "Performance Pay and Productivity." *American Economic Review* 90: 1346-61.

Terviö, Marko. "The Difference That CEOs Make: An Assignment Model Approach." *The American Economic Review*, vol. 98, no. 3, 2008, pp. 642-668.

Meyer, Margaret. 1991. "Learning from Coarse Information: Biased Contests and Career Profiles." *Review of Economic Studies* 58: 15-42.

Bar-Isaac, Heski. 2007. "Something to Prove: Reputation in Teams." *RAND Journal of Economics* 38: 495-511.

Gibbons, Robert, and Kevin J. Murphy. 1992. "Optimal Incentive Contracts in the Presence of Career Concerns: Theory and Evidence." *Journal of Political Economy* 100: 468-505.

Kaarbøe, Oddvar and Trond Olsen. 2008. "Distorted Performance Measures and Dynamic Incentives." *Journal of Economics and Management Strategy* 17: 149-83.

Gibbons, Robert and Michael Waldman. 1999. "Careers in Organizations: Theory and Evidence." Chapter 36 in Volume 3B of O. Ashenfelter and D. Card (eds.), *Handbook of Labor Economics*, North Holland.

Bénabou, Roland and Jean Tirole. 2006. "Incentives and Prosocial Behavior." *American Economic Review* 96: 1652-78.

Communication and feedback in organisations

Boleslavsky, Raphael & Lewis, Tracy R., 2016. "Evolving influence: Mitigating extreme conflicts of interest in advisory relationships," *Games and Economic Behavior*, Elsevier, vol. 98(C), pages 110-134

Ely, Jeffrey C. and Martin Szydlowski. 2020. "Moving the Goalposts," *Journal of Political Economy* 128:2, 468-506.

Goltsman, Maria, Hörner, Johannes, Pavlov, Gregory and Francesco, Squintani, 2009. "Mediation, arbitration and negotiation," *Journal of Economic Theory*, Elsevier, vol. 144(4), pages 1397-1420, July

Krishna, Vijay & Morgan, John. (2003). "The Art of Conversation: Eliciting Information from Experts Through Multi-Stage Communication". *Journal of Economic Theory*. 117. 147-179.

Lizzeri, Alessandro, Meyer, Margaret and Persico, Nicola, (2002), *The Incentive Effects of Interim Performance Evaluations*, Penn CARESS Working Papers, Penn Economics Department.