

University of Toronto

Economics 370Y: Economics of Organizations

2006-2007

Instructor: Prof. Arthur J. Hosios
Rm. 4075, 100 St. George St.
Office Hrs.: M 5:30-6:30
Tel. 416-978-8635
E-mail: ahosios@chass.utoronto.ca

The purpose of this course is to introduce students to the economic analysis of organizations. We develop an understanding of when markets can solve the problems of coordinating activities and motivating individuals; and, when markets are less successful, how business organizations and special contractual relationships emerge as alternative institutions for allocating resources.

Prerequisites: ECO 200/206; ECO 220/227 (or STA equivalent)

Lecture Topics and Reading Assignments

The articles and books listed below are available as a package, and can be purchased from Scholar House Productions, 100 Harbord Street. Students are responsible for the material described in square brackets following each reading (some changes may be made during the course). Questions based on each reading are available (using *Internet Explorer*) at <http://www.economics.utoronto.ca/hosios/>; a subset of these questions will reappear on term tests and the final examination. Additional questions may be provided. **Answers to these questions are not publicly available; the instructor will, however, review answers prepared by students.**

MR: Milgrom, P. and J. Roberts, *Economics, Organization and Management*, Prentice-Hall, 1992. (MR)

BDS: Besanko, D., Dranove, D. and M. Shanley, *The Economics of Strategy*, John Wiley & Sons, 1996. (BDS)

1. Introduction and Definitions

Stiglitz, J. (1993), "Organizations and the Real Cost of Interdependence," Appendix to Chap. 3 in *Economics*, Norton. [all]

MR (2) "Economic Organization and Efficiency" [19-28, 35-38]

Alchian, A. (1950), "Uncertainty, Evolution and Economic Theory," *Journal of Political Economy*, 58: 211-21. [all]

BDS (3) "The Vertical Boundaries of the Firm" [109-112, 115-119, 122-135]

2. Transaction Cost Economics

BDS (4) "The Transactions Costs of Market Exchange" [141-166]

Baron, J. and D. Kreps (1999), "Transaction Cost Economics," Appendix A in *Strategic Human Resources: Frameworks for General Managers*, John Wiley & Sons. [all]

BDS (5) "Organizing Vertical Boundaries" [169-177]

Gibbons, R. (2004) "Four Formal(izable) Theories of the Firm? mimeo [24-30]

3. TCE: Applications

Monteverde, K. & D. Teece (1982), "Supplier Switching Costs and Vertical Integration," *Bell Journal of Economics* 13:206-13. [all]

Joskow, P. (1987), "Contract Duration and Relationship Specific Investments: Empirical Evidence from Coal Markets," *American Economic Review* 77:168-185. [168-178]

4. Property Rights Theory

BDS (5) "Organizing Vertical Boundaries" [177-180]

Gibbons, R. (2004), "Control Rights," mimeo [all]

Hart, O. (1995), "The Property Rights Approach," pgs. 29-55 in *Firms, Contracts and Financial Structure*, Oxford University Press. [all]

5. PRT vs TCE

Holmstrom, B. & J. Roberts (1998), "The Boundaries of the Firm Revisited," *Journal of Economic Perspectives* 12: 73-94. [73-86]

Whinston, M. (2001), "Assessing the Property Rights and Transaction-Cost Theories of Firm Scope," *American Economic Review, Papers and Proc.* 91(2):184-188. [all]

6. Reputation and Relational Contracts

Shy, O. (1995), "Basic Concepts in Noncooperative Game Theory," Chap. 2 in *Industrial Organization: Theory and Applications*, MIT Press.

Kreps, D. (1990), "Corporate Culture and Economic Theory" in Alt, J. and K. Shepsle (eds.) *Perspectives on Positive Political Economy*, Cambridge University Press. [90-116]

Gibbons, R. (2004), "Make, Buy, or Cooperate?" mimeo [all]

7. Incentive Problems: Theory

- MR (7) "Risk Sharing and Incentive Contracts" [206-231]
 Holmstrom, B. (1999), "The Firm as a Subeconomy," *Journal of Law, Economics, and Organizations*, 15:74-102. [90-94]
 Prendergast, C. (1999), "The Provision of Incentives in Firms," *Journal of Economic Literature* 37:7-63. [44-49]
 Lazear, E. (1998), "Promotions as Motivators," Chapter 9 in *Personnel Economics for Managers*, John Wiley & Sons, 1998. [all]
 Gibbons, R. (2004), Agency Theory," mimeo [9-16]
 Holmstrom, B. & P. Milgrom (1991), "Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design," *Journal of Law, Economics, and Organizations*, 7, 24-51. [38-43]
 Gibbons, R. (2004), Relational Contracts," [10-16]

8. Incentive Problems: Applications

- Gibbons, R. and K. Murphy (1990) "Relative Performance Evaluation for Chief Executive Officers," *Industrial and Labor Relations Review*, 43: 30S-51S. [30S-41S]
 Lazear, E. (1999), *Journal of Labor Economics*, 17: 199-236. [Section I.C]
 Bertrand, M. & S. Mullainathan (2000), "Agents With and Without Principals," *American Economic Review, Papers and Proc.* 90(2):203-208. [all]

9. Allocation of Authority

- Aghion, P. & J. Tirole (1997), "Formal and Real Authority in Organizations," *Journal of Political Economy*, 105, 1-29. [1-13,18-21]
 Baker, G. Gibbons, R. & K. Murphy (1999), "Informal Authority in Organizations," *Journal of Law, Economics, and Organizations*, 15, 56-73 [56-59]

10. Firm Boundaries, Again

- Gibbons, R. (2004) "Four Formal(izable) Theories of the Firm? mimeo [14-16]
 MR (7) "Risk Sharing and Incentive Contracts" [231-232]
 Baker, G. & T. Hubbard (2003), "Make versus Buy in Trucking: Asset Ownership, Job Design, and Information," *American Economic Review* 93:551-572. [all]

Rules of the Game:

Assessment is based on 3 in-class tests and a final examination. The tests and exam each have a duration of 2 hours, are scheduled every 6-7 weeks throughout the course, and cover the material assigned since the previous test.

Test #1 October 18
Test #2 December 6
Test #3 February 14

The 3 in-class term tests count for 75% of the final grade (at 25% per test). An examination worth 25% of the final grade will be held during the spring examination period.

Missed Test: Students who miss a term test will be assigned a mark of zero for that test unless, **within 48 hours** of the test date, they submit to the instructor a written request for special consideration explaining the reason for missing the test. Appropriate documentation can be provided later; this documentation will either be a medical certificate indicating that the student was too ill to attend class or a college registrar's note.

Students with satisfactory explanations for having missed a test will arrange with the instructor to write a make-up test before the next class.