

ECON30017

Organizations, Economics and Incentives

SUBJECT GUIDE

Semester 2, 2013

Prepared by
Jun Xiao

Department of Economics
Faculty of Business and Economics



Course coordinator/lecturer/tutor

Jun Xiao

Room 531, FBE Building

Email: jun.xiao@unimelb.edu.au. Please include ECON30017 in the subject of your email.

Email Protocol

Please note that we are only able to respond to student emails coming from a University email address. Please do not use personal email addresses such as Yahoo, Hotmail or even business email addresses. Emails from non-University email addresses may be filtered by the University's spam filter, which means that we may not receive your email. All correspondence relating to this subject will only be sent to your University email address. Note that you must first activate your University email address before you can send or receive emails at that address. You can activate your email account at this link: <http://accounts.unimelb.edu.au/>.

Subject Overview

This subject is an introduction to the field of contract theory – it is about organizations and incentives. Why, how and when do we need to provide incentives? And why do organizations exist in the first place? What kind of incentives should be provided to agents (individuals or organizations) who may have private information, take hidden actions and attempt to manipulate others? In other words, what are the solutions to the moral hazard and adverse selection problems? Why property rights are important? What determines the boundaries and structure of firms? This subject will introduce main theoretical models as well as several key applications related to the above questions. Students will also be expected to apply the theories and principles to some real life applications.

Lecture and Tutorial Times

Lectures

Monday 12pm - 1pm, Medical-Frederic Wood Jones Theatre

Thursday 1pm - 2pm, MSLE-Lower Theatre

Tutorials

A one-hour tutorial once each week, beginning in the second week of the semester:

Thursday 2:15pm - 3:15pm, Old Quad-G11B (Cussonia Court Room 2)

Office hours

Monday 4pm-5pm, Room 531, FBE Building

Prerequisites

Econ30010 Microeconomics

This subject is best suited for someone with an interest in Economic Theory (particularly contract theory and similar fields) and its applications and/or someone who is planning to pursue Honour degree in the future.

Basic math methods:

- functions, including exponents
- derivatives, second derivatives, partial derivatives, product rule and chain rule
- unconstrained optimization of the function of one and several variables (how to find max and min)
- constrained optimization of the function of one and several variables = how to find max and min if there are some constraints (Lagrange's method) – I will assume that you do NOT have working knowledge of Lagrangian and explain how to use it.
- system of simultaneous equations
- quadratic equations
- probability theory (expectation, variance)

If you need to review some of the above, please use any material from your previous classes.

Textbooks

There is no one particular textbook that suits all topics. Reading will be provided on LMS or distributed in class. The interested students may want to consult some of the following books:

1. Paul Milgrom and John Roberts. *Economics, Organization and Management*, Prentice Hall, 1992
2. Donald E. Campbell. *Incentives: Motivation and the Economics of Information*, Cambridge (2nd edition), 2006
3. Ines Macho-Stadler and J. David Perez-Castrillo. *An introduction to the Economics of Information*, Oxford (2nd edition), 2001
4. Patrick Bolton and Mathias Dewatripont. *Contract Theory*, The MIT Press, 2005
5. Hart, O. *Firms, Contracts and Financial Structure*, Oxford University Press, 1995
6. Roberts, J. *The Modern Firm: Organizational Design for Performance and Growth*, Oxford University Press, 2007
7. Salanie, B. *The Economics of Contracts: A Primer*, The MIT Press, 1997
8. Jean-Jacques Laffont and David Martimort. *The Theory of Incentives: The Principal-Agent Model*, Princeton University Press, 2001

Assessment Overview

The assessment will cover the material presented in lectures, tutorials, home assignments and the required readings.

The assessment will comprise:

- 2-hour end-of-semester examination (80%)
- 5 home assignments (contribute 20% - see below).

Note that the main reason to do the assignments is not to get a good mark (it contributes only 20%, which is not that much), but prepare you for the exam.

Assignments

One is not likely to achieve understanding from the explanation of another. Understanding is achieved by solving problems (Michael Wetzstein).

There will be 5 home assignments:

- 4 best marks will contribute 20% to the final mark. That means that you can skip one assignment due to illness, some act of god or just plain laziness without any penalty.
- Each assignment will be marked out of 20 points. Late submissions will incur **penalty of 5 points for each extra day**.

You are encouraged to work together in groups on home assignments, but you have to write down your solution by yourself. If you need help with your assignment you are welcome to submit your questions to me through emails or just to talk to me in person.

Solutions to the assignments and marks will be posted on LMS.

Tutorials

are essential for the subject. The purpose of the tutorials is for you to practice solving problems with the guidance of the tutor. Tutorial problems are very similar to the exam and assignment problems, so working through them in tutorials will help you with the assignments and the exam.

The tutorial problems will be posted on LMS the week before and the solutions will be posted at the end of the week. You are not required to solve the tutorial problems before each tutorial, but attempting it will improve your understanding dramatically. Your tutorials should be done medium (medium-rare is acceptable, rare is not advisable, and well-done will make you bored to death...)

If you come to the tutorials unprepared, most of the time you will not be able to understand the solution - so don't waste your time in such a manner! Sometimes tutorials will cover new/complimentary material - in that case no prior knowledge/preparation is expected - you will work out the solution together with your tutor.

You should not expect to be able to solve the problems easily – that would require some practice on your part. Only after you worked on the material from the lectures, reading, tutorial and home assignments, you should be able to solve the problems with confidence.

LMS

On the homepage you will find

- Subject syllabus and reading guide
- Lecture slides, lecture audio
- Tutorial problems and solutions
- Assignments with solutions and marks
- Exam preparation, including previous exams

Topics to be covered (tentative, subject to students' interests and background)

1. Market and Efficiency
Case studies, general equilibrium, the First Welfare Theorem, the value maximization principle, the Coase Theorem, market failures.
2. Coordination and Management
Motivation and employment moral hazard, with multitasking, with several agents, relative performance evaluation, tournaments, competition among agents, supervision and collusion, rent-seeking.
3. Boundaries of the Firm
Bounded rationality, incomplete contracts, hold-up problem.
4. Subject Review and Exam Preparation

OTHER INFORMATION

Exam Policy

The Faculty requires that you are available for the entire examination period. Supplementary exams will not be provided in cases of absence during the examination period, unless the absence is due to serious illness or other serious circumstances. See the Special Consideration web site for more information:

http://fbe.unimelb.edu.au/csc/assistance/special_consideration

Special Consideration

Students who have been significantly affected by illness or other serious circumstances during the semester may be eligible to apply for Special Consideration.

The following website contains detailed information relating to who can apply for Special Consideration and the process for making an application:

http://fbe.unimelb.edu.au/csc/assistance/special_consideration

Plagiarism and Collusion

Presenting material from other sources without full acknowledgement (referred to as plagiarism) is heavily penalised. Penalties for plagiarism can include a mark of zero for the piece of assessment or a fail grade for the subject.

Plagiarism is the presentation by a student of an assignment identified as his or her own work even though it has been copied in whole or in part from another student's work, or from any other source (e.g. published books, web-based materials or periodicals), without due acknowledgement in the text.

Collusion is the presentation by a student of an assignment as his or her own work when it is, in fact, the result (in whole or in part) of unauthorised collaboration with another person or persons. Both the student presenting the assignment and the student(s) willingly supplying unauthorised material are considered participants in the act of academic misconduct.

See <http://academichonesty.unimelb.edu.au/> for more information.

Using Lecture Capture (Echo 360)

Audio recordings of lectures delivered in this subject will be made available for review in the days following each lecture. Audio recordings of lectures allow you to revise lectures during the semester, or to review lectures in preparation for the end of semester exam.

You can access recorded lectures by clicking on the Lecture Recordings (or similar) menu item in the LMS page for this subject.

To listen to lecture recordings, you must install QuickTime 7 (or a later version) on your computer.

Please note that lecture recordings are not a substitute for attendance; rather they're designed for revision. On rare occasions the lecture capture system can fail to record the lecture due to technical reasons. In such cases, the lecture recording will not be made available.

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FBE Centre for Excellence in Learning and Teaching

The FBE Centre for Excellence in Learning and Teaching (CELT) provides services and resources to enhance your learning in Business and Economics.

Maximize your academic success by taking part in CELT services that develop:

- Skills in research, referencing and academic writing
- Mastery of different assignment types
- Effective study techniques
- Abilities to learn effectively with your peers
- Transition to the faculty and understanding of academic expectations

The Centre also provides an extensive range of helpsheets that can enhance your academic performance in Business and Economics. These are available online or at the Centre.

Visit the CELT site www.fbe.unimelb.edu.au/celt to learn more and get involved.