Lecture & seminar notes available on moodle.rhul.ac.uk

Aims
EC2212 is a half-unit course for second-year economics undergraduates. It covers the principal-agent problem, the Coase theorem, theories of the firm, the role of transaction costs, moral hazard, adverse selection, and issues surrounding organization, investment, governance and expansion of corporations. Essentially, we will try to answer the question “how do I get other people to act in my interest?” Throughout the course, we will also look at how the theory applies to current and historic events in the UK, US, and Japan. The historical and international perspective should help students acquire a more thorough understanding of the theoretical framework and allow them to appreciate how economic reality have evolved over time.

Learning outcomes
At the end of the course, students should:
  o Appreciate why (and how) incentives matter.
  o Understand how conflicts of interests shape economic interactions and how they can be solved.
  o Learn about the role of transaction costs in determining the existence, scale and scope of firms.
  o Understand why government regulation may be inferior to market solutions when dealing with externalities.
  o Have a basic knowledge of the developments of Anglo-American industrial and Japanese capitalism.

Prerequisites
Students should be taking a second-year microeconomics course concurrently. (Students who are not doing so are at a distinct disadvantage and are advised to get in touch with me first.) It is taken for granted that students are able to maximize simple utility functions impromptu.

Assessment
75% of the grade will be determined by a closed-book 2-hour written exam taken during Exam term (autumn only visiting student will do an oral assessment instead of the written exam).

Weekly quizzes account for 20% of the final mark. During the term, there will be 8 or 9 quizzes of which 4 are randomly selected and weighted at 5% each. Weekly quizzes test your understanding of recently discussed topics and will usually feature a repetition part as well as a transfer part. To access a quiz, students may have to pass a “pre-quiz” to ensure essential basic knowledge of the topics.
A short essay (ca. 500-600 words) accounts for 5% of the final mark. The essay should apply concepts learned in the course to everyday situations. The grade is based on originality of the topic and thoroughness of the analysis.

**Other work**
An optional take-home-exam (THE) will be available to prepare for the exam. Failure to attend lectures and seminars, attempt quizzes and/or submit the essay may mean that the student will be given an “Attendance Fail” for the entire course. Attendance Fail may affect your progression to the third year.

**Structure of the course**

Lecture I: Introduction
Lecture II: Existence of Firms, Transaction Costs
Lecture III: Externalities, Pigovian Tax, Coase Theorem
Lecture IV: Principal Agent Theory, Contracts, Commitment Problem
Lecture V: Adverse Selection, Moral Hazard
Lecture VI: Ownership
Lecture VII: Incentive Schemes
Lecture VIII: Corporate Finance
Lecture IX: Historic Developments
Lecture X: Comparison of Japan and the US

**Delivery**
The lecture will be primarily lecturer driven, although the opportunity exists to include certain topics upon student’s request (e.g. current political developments) into the course as appropriate. During each lecture, there will be frequent short quizzes using instant polling technology allowing students to receive feedback on their understanding of current or earlier topics. In addition, from time to time video clips will be used to illustrate certain points from a different perspective or to provide real-life examples.
The course will be roughly split in two parts. The first one (ca. 2/3) focusses on the introduction of the main ideas and concepts using both formal (read mathematical) and informal approaches. The second one (ca. 1/3) discusses open issues, applications and problems of the concepts learned in the first part in various real-life settings.
Seminar will be primarily used to solve problem sets, which mostly contain mathematical problems that exemplify recently learned concepts.
The textbook and other readings go into the ideas and concepts in greater depth. Students are expected to work through these on their own, although certain topics can be discussed in lecture or seminar upon request as appropriate.

**Expectations**
Students are expected to do the readings and attempt quizzes and the problem sets before the seminars. Students who do not keep up with the work will find themselves in great difficulty due to the continuous assessment.
Note: Exam questions will partly follow those in the worksheets, partly be open questions that requires students to apply learned concepts. From past years’ experience, students who do the problems in the worksheets and attend lectures regularly do well in the final exam.
Textbook
Available at Bedford.
All readings are compulsory and contain assumed knowledge for the exam.
Readings not in the textbook are all available through Moodle.

Lecture topics & readings
Topic/Reading(s)
Introduction to economic organization
(a) M&R, Chapter 1

Transaction costs and the Coase Theorem
(a) M&R, Chapter 2

Contracts, information and incentives
(a) M&R, pp. 136-9, 140-4, 149-53, 167-70, 179-85
(b) Mandatory reading on Moral Hazard – on Moodle

Markets versus hierarchies
(a) M&R, Chapter 16

Property rights and the firm
(a) M&R, Chapter 9

Moral hazard and the firm
(a) M&R, pp. 136-9, 179-85

Hold-up and the firm
O. Hart, “An Economist’s Perspective on the Theory of the Firm”

Rise of big business in the US

Modern industrial capitalism in Japan

Further readings are assigned during the lecture. Additional optimal reading (i.e. not exam relevant) will be made available on moodle.