

Southern Methodist University
Department of Economics

Topics in Economic Theory
ECO 7302
Spring 2018

Time: Tuesday: 6:30 pm-9:20 pm

Place: Umphrey Lee 301S

Instructor: Dr. Saltuk Ozerturk

Office: Lee 301X

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Course Description: This is a theoretical graduate course in Economics of Information, Contract Theory and its applications. The first part of the course will cover the basic textbook material for Contract Theory such as Screening, Signaling, Moral Hazard, Team Incentives, Collusion, Supervision, Auditing and Career Concerns. The second part of the course will focus on some special topics such as Strategic Trading with Private Information, Economics of Experts Services, Certification Intermediaries such as Credit Rating Agencies and Media Economics

Office Hours: Tuesday and Thursday 3:00-5:00 pm or by appointment.

Textbook: **Contract Theory by Bolton and Dewatripont, MIT Press, 2005**

Grading: The course grade will be based on, 2 take-home midterm exams, 2 in-class presentations and one research proposal with the following weights:

- **2 Midterm Exams:** 30% each (Take Home).
- **2 In-Class Presentations:** (15% each) Each student will give a presentation of two papers chosen from the list at the end of this syllabus. Each presentation will take 60 minutes.
- **Research Proposal (10%):** Each student will submit a short research proposal.

Disability Accommodations.

Students needing academic accommodations for a disability must first register with Disability Accommodations & Success Strategies (DASS). Students can call 214-768-1470 or visit <http://www.smu.edu/Provost/ALEC/DASS> to begin the process. Once registered, students should then schedule an appointment with the professor as early in the semester as possible, present a DASS Accommodation Letter, and make appropriate arrangements. Please note that accommodations are not retroactive and require advance notice to implement.

Religious Observance

Religiously observant students wishing to be absent on holidays that require missing class should notify me in writing at the beginning of the semester, and should discuss with me, in advance, acceptable ways of making up any work missed because of the absence. (See University Policy No. 1.9.)

Excused Absences for University Extracurricular Activities

Students participating in an officially sanctioned, scheduled University extracurricular activity will be given the opportunity to make up class assignments or other graded assignments missed because of their participation. It is the responsibility of the student to arrange with me prior to any missed scheduled examination or other missed assignment for making up the work. (University Undergraduate Catalogue)

Student Learning Outcomes

- Students will be able to use advanced contract-theoretic modeling techniques in their own future research.
- Students will be able to read and discuss advanced theoretical contributions in the area of information economics and contract theory.
- Students will be able to pose new research questions based on their detailed presentations of key research contributions in the topics covered in class.
- Students will be able to develop and demonstrate presentation skills that will enable them communicate their own research to professional academic audiences.

Course Outline

Part 1: Basic Contract Theory

- **Simple Economics of Adverse Selection, Hidden Information: Screening (BD Chapter 2.1)**
 - Applications: Credit Rationing, Optimal Income Taxation, Regulation (BD, Chapter 2.2)
- **Hidden Information: Signaling (BD Chapter 3)**
 - Spence's Model of Education as a Signal (BD, Chapter 3.1)
 - Application: Signaling Through Dividend Policy (BD, Chapter 3.2.2)
- **Hidden Action: Moral Hazard (BD Chapter 4)**
 - First-Best and Second Best Contracts (BD, Chapter 4.1)
 - The Second Best with Bilateral Risk Neutrality and Resource Constraints for the Agent
 - Linear Contracts, Normal-CARA model
 - Managerial Incentive Schemes
 - Risky Debt as Optimal Contract under Moral Hazard
- **Multi-dimensional Incentive Problems (BD Chapter 6)**
 - Multiple Tasks and Effort Substitution (BD Chapter 6.2.1)
 - Moral Hazard with Conflicting Tasks (BD Chapter 6.2.2)
- **Multi-agent Moral Hazard and Collusion (BD Chapter 8)**
 - Moral Hazard in Teams with Observable Individual Outputs (BD Chapter 8.1.3)
 - Cooperation and Collusion among Agents (BD Chapter 8.2)
 - Application: Auditing (BD Chapter 8.3)
- **Career Concerns (BD Chapter 10.5)**
 - Trade-off between talent risk and incentives under career concerns (BD Chapter 10.5.3)

Part 2: "Special" Topics

- **Markets and Private Information: Two Standard Models of Informed Trading**
 - **Grossman and Stiglitz (1980):** Competitive Noisy Rational Expectations Framework: On the Impossibility of Informationally Efficient Markets, *AER* 61, 393-408.
 - **Kyle, Albert (1985):** Strategic Trading with Information: Continuous Auctions and Insider Trading, *Econometrica* 53, 1315-1335

- **Economics of Experts Services (Credence Goods)**
 - **Fong, Yuk-Fai, 2005,** When Do Experts Cheat and Whom Do They Target? *RAND Journal of Economics*, 36(1), pp. 113-130
 - **Wolinsky, A. 1993,** Competition in Markets for Informed Experts' Services, *RAND Journal of Economics*, 24(3), pp. 380-398.

- **Credit Rating Agencies (Certification Intermediaries)**
 - **Opp, Opp and Harris 2013,** Rating Agencies in the Face of Regulation *Journal of Financial Economics* 108, 46-61
 - **Bar-Isaac and Shapiro, 2013,** Rating Quality over the Business Cycle, *Journal of Financial Economics* 108, 62-78

- **Political Economy of the News Media**
 - **Besley, Timothy, and Andrea Prat. 2006.** "Handcuffs for the Grabbing Hand? Media Capture and Government Accountability." *American Economic Review* 96 (3): 720-736.
 - **Gehlbach, Scott, and Konstantin Sonin. 2014.** "Government Control of the Media". *Journal of Public Economics* 118: 163-171.

List of Papers for Presentations

- 1) **Benabou, R., and Laroque, G.**, 1992, Using privileged information to manipulate markets: insiders, gurus and credibility, *Quarterly Journal of Economics*, 107(3), 921-958.
- 2) **Bolton, Frexias and Shapiro**, 2012, Credit Ratings Game, *Journal of Finance*, 67-85-112
- 3) **Perotti, E.C. (1995)** Credible privatization. *American Economic Review*, 85 (4), 847-859.
- 4) **Dewatripont and Tirole (1999)** Advocates, *Journal of Political Economy*, 107, p. 1-39
- 5) **Aghion and Tirole**, 1997, Formal and Real Authority in Organizations, *Journal of Political Economy*, 105: pages 1-29
- 6) **Manso Gustavo (2011)** Motivating Innovation. *Journal of Finance*, vol. 66, pp. 1823-1869, 2011.
- 7) **Alger, I., Salanie, F. 2006.** A theory of fraud and over-consumption in experts markets. *Journal of Economics and Management Strategy*_15 (4), 853–881.
- 8) **Ellman, Matthew, and Fabrizio Germano.** 2009. "What Do the Papers Sell? A Model of Advertising and Media Bias." *Economic Journal* 119: 680--704.
- 9) **Duggan John, and Cesar Martinelli.** 2010. "A Spatial Theory of Media Slant and Voter Choice." *Review of Economic Studies* 78 (2): 640-666.
- 10) **Bernhardt, Dan, Stefan Krasa, and Mattias Polborn.** 2008. "Political Polarization and the Electoral Effects of Media Bias." *Journal of Public Economics* 92: 1092--1104.
- 11) **Gentzkow, Matthew, Jesse M. Shapiro, and Daniel Stone.** 2016. "Media Bias in the Marketplace: Theory." *Handbook of Media Economics*. Chapter 14, edited by Simon Anderson, David Strömberg and Joel Waldfogel (Eds.).

- 12) **Strömberg, David.** 2016. "Media Coverage and Political Accountability: Theory and Evidence." Handbook of Media Economics. Chapter 17, Simon Anderson, David Strömberg and Joel Waldfogel (Eds.).

- 13) **Anderson, Simon P., and John McLaren.** 2012. "Media Bias and Media Mergers with Rational Consumers." Journal of the European Economic Association 10 (4): 831-859.