

ECO 741
Theory of the Firm and Market Structure
Fall 2015

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ECO 741 and 742 comprise the graduate sequence in industrial organization. Professors Creane, Bagh, and I will attempt to survey much of the field of IO, hence we will cover many subjects but our treatment of any one topic may not be overly extensive. In this first third of the two-course sequence we will introduce the field and discuss history of thought in IO, the theory of the firm, and public policy involving competition and collusion. The course is designed for graduate students in economics, agricultural economics, and business administration. ECO 741 and 742 together are designed to prepare students to take the field exam in industrial organization and to write a dissertation in the area of industrial organization. Suggested prerequisites are ECO 601 (price theory) and ECO 703 (econometrics).

Some of the readings will be taken from Jean Tirole's The Theory of Industrial Organization, so you are strongly urged to purchase the text. Other reading assignments will come from journal articles as noted on the course outline below. We will also draw from other texts and collections of readings, including R. Schmalensee and R. Willig, Handbook of Industrial Organization (Volumes 1 and 2), North Holland, 1989. Two excellent IO textbooks (written at a slightly lower level than Tirole) that you might want to use as references are D. Carlton and J. Perloff, Modern Industrial Organization (4th ed., Pearson, Addison Wesley, 2004) and Luis Cabral, Industrial Organization (MIT Press, 2000).

Your grade for this portion of ECO 741 will be determined as follows:

research paper proposal (due 10/28/15)	30%
take-home exam (due 11/2/15)	60%
class preparation and participation	10%

For the research paper proposal portion of your grade, there are several acceptable approaches. You can develop a stand-alone paper for the 741-742 sequence, and the research paper proposal for this class can formulate the idea and research the literature. Or you can use this assignment to flesh out the beginnings of a dissertation proposal. Or if you plan to write a dissertation in another field, you can develop IO connections to your chosen dissertation topic. For inspiration I would encourage you to look at papers published in industrial organization field journals like the Rand Journal of Economics, the Journal of Industrial Economics, the International Journal of Industrial Organization, and the Review of Industrial Organization. I would like to meet with each of you individually sometime in mid-to-late September to discuss your plan. Each of you will have the opportunity to present a brief summary of your paper during the next-to-the-last class meeting on October 28.

You will be given reading assignments prior to each class meeting. I expect you to come to class prepared to discuss these assignments. Your grade for class preparation and participation will be determined by the extent to which you contribute to the group discussion.

COURSE OUTLINE AND READING LIST

I. INTRODUCTION (8/26, 8/31)

*R. Schmalensee, "Industrial Organization," in The New Palgrave: A Dictionary of Economics, vol. 2, pp. 803-808. For a longer version, see his paper "Industrial Economics: An Overview," in The Economic Journal, September 1988, 643-681.

F. Scherer and D. Ross, Industrial Market Structure and Economic Performance (3rd edition) Houghton Mifflin, 1990, Ch. 1, "Introduction."

*E. T. Grether, "Industrial Organization: Past History and Future Problems," American Economic Review, May 1970, 83-89.

E. S. Mason, "Price and Production of Large-Scale Enterprise," American Economic Review, March 1939, 61-74.

R. Schmalensee, "'On a level with dentists'? Reflections on the Evolution of Industrial Organization," Review of Industrial Organization, 2012, 157-179.

II. COST STRUCTURE AND MARKET ORGANIZATION (9/2)

*J. C. Panzar, "Technological Determinants of Firm and Industry Structure," Handbook of Industrial Organization, North Holland, 1989, Ch. 1, pp. 4-41.

W. J. Baumol, "Contestable Markets: An Uprising in the Theory of Industry Structure," American Economic Review, March 1982, 1-15.

F. Scherer and D. Ross, "Chapter 4: The Determinants of Market Structure," Industrial Market Structure and Economic Performance (3rd edition) Houghton Mifflin, 1990.

D. Evans and J. Heckman, "A Test for Subadditivity of the Cost Function with an Application to the Bell System," American Economic Review, September 1984, 615-623. See also comment and errata, AER, 9/86.

III. MONOPOLY VS. COMPETITION (9/9, 9/14)

*Tirole, pp. 65-78.

G. Stigler, The Organization of Industry, University of Chicago Press, 1968, Ch. 2, "Competition," Ch. 4, "The Measurement of Concentration."

A. Lerner, "The Concept of Monopoly and the Measurement of Monopoly Power," Review of Economic Studies, June 1934, 157-175.

A. Harberger, "Monopoly and Resource Allocation," American Economic Review, May 1954, 77-87.

R. Posner, "The Social Costs of Monopoly and Regulation," Journal of Political Economy, August 1975, 807-828.

*R. Schmalensee, "Inter-Industry Studies of Structure and Performance," Ch. 16, Vol. 2 of Handbook of Industrial Organization.

J. Bain, "Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940," Quarterly Journal of Economics, August 1951, 293-324.

Journal of Industrial Economics, June 1984 special issue on the market structure-performance debate.

IV. PUBLIC POLICY TOWARDS COMPETITION AND MONOPOLY (9/16, 9/21, 9/23, 9/28)

U.S. Department of Justice, *Antitrust Enforcement and the Consumer*,
<http://www.justice.gov/sites/default/files/atr/legacy/2015/03/06/antitrust-enfor-consumer.pdf>

E. Mason, "Monopoly in Law and Economics," Yale Law Journal, November 1937, 34-49.

*U.S. Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines*,
<http://www.justice.gov/atr/public/guidelines/hmg-2010.html>

G. Stigler and R. Sherwin, "The Extent of the Market," The Journal of Law and Economics, October 1985, 555-587.

Tirole, pp. 209-224.

U.S. Department of Justice, *Price Fixing, Bid Rigging, and Market Allocation Schemes*,
<http://www.justice.gov/sites/default/files/atr/legacy/2007/10/24/211578.pdf>

A. Fraas and D. Greer, "Market Structure and Price Collusion: An Empirical Analysis," The Journal of Industrial Economics, September 1977, pp. 21-44.

*R. Lanzillotti, "The Great School Milk Conspiracies of the 1980s," Review of Industrial Organization, August 1996, pp. 413-458.

*F. Scott, "Great School Milk Conspiracies Revisited," Review of Industrial Organization, November 2000, pp. 325-341.

D. Barrus and F. Scott, "Single Bidders and Tacit Collusion in Highway Procurement Auctions," working paper, University of Kentucky, June 2015.

V. THEORY OF THE FIRM (9/30, 10/5, 10/7, 10/12, 10/14)

*Tirole, pp. 15-34.

*O. Hart, "An Economist's Perspective on the Theory of the Firm," Columbia Law Review, 1989, 1757-1774.

R. Coase, "The Nature of the Firm," Economica, Nov. 1937, pp. 386-405.

A. Alchian and H. Demsetz, "Production, Information Costs, and Economic Organization," American Economic Review, Dec. 1972, pp. 777-795.

O. Williamson, "The Modern Corporation: Origins, Evolution, and Attributes," Journal of Economic Literature, Dec. 1981, pp. 1537-1568.

*B. Holmstrom and J. Roberts, "The Boundaries of the Firm Revisited," Journal of Economic Perspectives, Fall 1998, 73-94.

S. Grossman and O. Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration," Journal of Political Economy, August 1986, pp. 691-719.

*Tirole, pp. 35-51.

F. Machlup, "Theories of the Firm: Marginalist, Behavioral, and Managerial," American Economic Review, March 1967, pp. 1-33.

M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure," Journal of Financial Economics, Oct. 1976, pp. 305-360.

E. Fama, "Agency Problems and the Theory of the Firm," Journal of Political Economy, April 1980, pp. 288-307.

*G. Baker and T. Hubbard, "Make versus Buy in Trucking: Asset Ownership, Job Design, and Information," American Economic Review, June 2003, 551-572.

G. Baker and T. Hubbard, "Contractibility and Asset Ownership: On-Board Computers and Governance in U. S. Trucking," Quarterly Journal of Economics, November 2004, 1443-1478.

VI. VERTICAL INTEGRATION, VERTICAL CONTROL (10/19, 10/21, 10/26)

*Tirole, pp. 169-186.

A. Hortacsu and C. Syverson, "Cementing Relationships: Vertical Integration, Foreclosure, Productivity, and Prices," Journal of Political Economy, 2007, 250-301.

*F. Mathewson and R. Winter, "The Economics of Vertical Restraints in Distribution," in J. E. Stiglitz and G. F. Mathewson, New Developments in the Analysis of Market Structure, The MIT Press, 1986.

*P. Kaufmann and F. Lafontaine, "Costs of Control: The Source of Economic Rents for McDonald's Franchisees," The Journal of Law and Economics October 1994, 417-453.

P. Rubin, "The Theory of the Firm and the Structure of the Franchise Contract," Journal of Law and Economics, 1978, 223-233.

F. Scott, "Franchising vs. Company Ownership as a Decision Variable of the Firm," Review of Industrial Organization, February 1995, 69-81.