

RM COURSE COMPETITION AND REGULATION

Bert Willems

Part 1: Reading group on “Recent developments in the theory of regulation”

Goals

- Study the main concepts of regulation **theory**
- Obtain **overview of different principle agent models** with a focus on adverse selection
- Not an in depth discussion of each single paper, but rather understanding the relation between papers and the main lines of arguments in each paper
- Obtain an insight in some of the formal derivations

To-do

- Everyone should read the main text by (Armstrong & Sappington, 2007).
- This year I would like rely also on the text by (Laffont & Martimort, 2009) , which is a graduate textbook on principle-agent theory. It covers a subset of the elements in A&S . It is more formal, but explains well.
- One or two people are responsible for presenting one topic based on the material of A&S and L&S. Other people might ask questions during the class.

Main material

Armstrong, M., & Sappington, D. E. M. (2007). Chapter 27 Recent Developments in the Theory of Regulation. In M. A. and R. Porter (Ed.), *Handbook of Industrial Organization* (Vol. 3, pp. 1557–1700). Elsevier.

<http://www.sciencedirect.com/science/article/pii/S1573448X06030275>

Laffont, J.-J., & Martimort, D. (2009). *The Theory of Incentives: The Principal-Agent Model*. Princeton University Press.

Week 1

Introduction

- A&S §1-§2.2
- L&M §1 Incentives in economic thought

Regulation under adverse selection

- A&S (§2.3)
 - (Skip “unknown scope for cost reduction”)
 - Skip: 2.3.3. A unified analysis
- L&M (§2.1-§2.9): Basic model of adverse selection
- L&M (§3.3): Type-dependent participation constraints / Countervailing incentives

Baron, D. P., & Myerson, R. B. (1982). Regulating a Monopolist with Unknown Costs. *Econometrica*, 50(4), 911–930. <http://doi.org/10.2307/1912769>

Lewis, T. R., & Sappington, D. E. M. (1989). Countervailing incentives in agency problems. *Journal of Economic Theory*, 49(2), 294–313. [http://doi.org/10.1016/0022-0531\(89\)90083-5](http://doi.org/10.1016/0022-0531(89)90083-5)

Loeb, M., & Magat, W. A. (1979). A Decentralized Method for Utility Regulation. *The Journal of Law & Economics*, 22(2), 399–404.

Multi-dimensionality of types

- A&S, §2.4.3
- L&M. §3.2.

Armstrong, M., & Rochet, J.-C. (1999). Multi-dimensional screening:: A user's guide. *European Economic Review*, 43(4–6), 959–979. [http://doi.org/10.1016/S0014-2921\(98\)00108-1](http://doi.org/10.1016/S0014-2921(98)00108-1)

Dana Jr., J. D. (1993). The Organization and Scope of Agents: Regulating Multiproduct Industries. *Journal of Economic Theory*, 59(2), 288–310. <http://doi.org/10.1006/jeth.1993.1019>

Week 2

Dynamic interaction

- A&S, §2.5
- Full Commitment: L&M §8.1.
- Dynamics and limited commitment L&M §9.3.

Laffont, J.-J., & Tirole, J. (1990). Adverse Selection and Renegotiation in Procurement. *The Review of Economic Studies*, 57(4), 597–625. <http://doi.org/10.2307/2298088> (renegotiation)

Regulatory capture

- A&S (§2.4.2)

Laffont, J.-J., & Tirole, J. (1991). The Politics of Government Decision-Making: A Theory of Regulatory Capture. *The Quarterly Journal of Economics*, 106(4), 1089–1127. <http://doi.org/10.2307/2937958>

Multiple products

- A&S, §4.5
- L&M, 2.10.3

Alternative models: Moral hazard

- A&S, §2.6
- L&M: §4 (Let's not focus too deep on this part).

Alternative model: "false moral hazard models"

- L&M (§7.1.4): “False Moral Hazard” models

Laffont, J.-J., & Tirole, J. (1986). Using Cost Observation to Regulate Firms. *Journal of Political Economy*, 94(3), 614–641.

Week 3

Audits

- A&S, §2.4.1
- Audit L&M §3.6

Yardstick Competition

- A&S, §4.1.1 Yardstick performance

Shleifer, A. (1985). A Theory of Yardstick Competition. *The RAND Journal of Economics*, 16(3), 319–327. <http://doi.org/10.2307/2555560>

- A&S, §4.1.2 Yardstick reporting setting
- L&M §2.14.1/§2.14.2: Informative signals to improve contracting

Dana Jr., J. D. (1993). The Organization and Scope of Agents: Regulating Multiproduct Industries. *Journal of Economic Theory*, 59(2), 288–310. <http://doi.org/10.1006/jeth.1993.1019>

Week 4

One-way access pricing

- (A&S, §5.1)

Two-way access pricing

- (A&S §5.3)