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## **Economics 260B. Economics of Transition II: Governance and Institutions**

While Economics of Transition I focuses on the issues of the political economy of reform and allocative changes during the transition from plan to market, Economics of Transition II studies the issues of governance and institutions underlying transition and development. The transition experience in Central and Eastern Europe and in Asia has raised many new questions for economics, in particular, for the economics of organization and institution. This course is organized around the three categories of institutions: firms, markets, and the state. It investigates, both theoretically and empirically, how different organizations work and how alternative institutional arrangements hinder, support, or help efficiency improvement in transition economies.

One of the course requirements is a research paper on a selected topic covered in the course. Students should decide on their own research project and submit the paper by Monday August 25, 2003.

### **I. Introduction: Economic Systems and Institutional Economics**

#### **A. The Nature of the Socialist System**

Kornai, Janos, *The Socialist System: The Political Economy of Communism*, Princeton and Oxford University Press, 1992. Chapters 3, 4, 5, 6, 7, 8, and 15.

Ericson, Richard, "The Classical Soviet-Type Economy: Nature of the System and Implications For Reform," *Journal of Economic Perspectives*, Summer, 1991.

#### **B. Fundamental Ideas about the Market System**

Hayek, Friedrich A., "The Use of Knowledge in Society," *American Economic Review*, 35:519-30, 1945.

Coase, Ronald, "The Problem of Social Cost," *Journal of Law and Economics*, 3:1-44, October, 1960.

#### **C. The New Institutional Economics**

Coase, Ronald. "The New Institutional Economics," *Journal of Theoretical and Institutional Economics*, 140(1), 229-231, 1984.

Williamson, Oliver. "Reflections on the New Institutional Economics," *Journal of Theoretical and*

*Institutional Economics*, 141(1), 187-195, 1985.

North, Douglass. "The New Institutional Economics," *Journal of Theoretical and Institutional Economics*, 142(1), 230-237, 1986

Williamson, Oliver. *Markets and Hierarchies*. New York: The Free Press, 1974.

Williamson, Oliver. *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting*. New York: Free Press, 1985.

North, Douglass. *Institutions, Institutional Change, and Economic Performance*. Cambridge: Cambridge University Press, 1990.

Eggertsson, Thrainn. *Economic Behavior and Institutions*, New York: Cambridge University Press, 1990.

Furubotn, Eirik; and Rudolf Richter. *Institutions and Economic Theory: The Contribution of the New Institutional Economics*, The University of Michigan Press, 1997.

## **II. Firms**

### **A. Dynamic Incentives: The Ratchet Effect and Soft Budget Constraint**

Weitzman, Martin, "The Ratchet Principle and Performance Incentives," *Bell Journal of Economics*, 1980.

Laffont, Jean-Jacques, and Jean Tirole, "Adverse Selection and Renegotiation in Procurement," *Review of Economic Studies*, 57, 579-625, 1990.

Kornai, Janos, "The Soft Budget Constraint," *KYKLOS*, 39(1):3-30, 1986.

Dewatripont, Mathias, and Eric Maskin, "Credit and Efficiency in Centralized and Decentralized Economies," *Review of Economic Studies*, October, 1995.

Maskin, Eric, "Theories of the Soft Budget Constraint," *Japan and the World Economy*, 8, 1996.

Li, David D., "Causes of the Soft Budget Constraint: Evidence on Three Explanations," *Journal of Comparative Economics*, March, 1998.

### **B. Theory of Government Ownership and Privatization**

Sappington, David, and Joseph Stiglitz, "Privatization, Information, and Incentives," *Journal of Policy Analysis and Management*, 6:567-582, 1987.

Schmidt, Klaus, "The Costs and Benefits of Privatization: An Incomplete Contracts Approach," *Journal of Law, Economics, and Organization*, 12(1):1-24, 1996.

Shleifer, Andrei and Robert W. Vishny, "Politicians and Firms," *Quarterly Journal of Economics*, CIX:995-1025, November, 1994.

Li, David D. "A Theory of Ambiguous Property Rights in Transition Economies," *Journal of Comparative Economics*, 23:1-19, 1996.

Che, Jiahua, and Yingyi Qian, "Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises," *Journal of Law, Economics, and Organization*, April 1998, 14(1), pp. 1-23.

Che, Jiahua, and Yingyi Qian, "Insecure Property Rights and Government Ownership of Firms," *Quarterly Journal of Economics*, May 1998, 113(2), pp. 467-496.

### **C. Corporate Governance**

Berle, Adolf A. and Gardiner Means, *The Modern Corporation and Private Property*, New York: MacMillan, Co. 1933.

Jensen, Michael, and William Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure," *Journal of Financial Economics*, 5, 1976.

Jensen, Michael, and Eugene Fama, "Separation of Ownership and Control," *Journal of Law and Economics*, 26, 1983.

Demsetz, Harold, and Kenneth Lehn, "The Structure of Corporate Ownership: Causes and Consequences," *Journal of Political Economy*, 93(6):1155-77, 1985.

Shleifer, Andrei and Robert Vishny, "Large Shareholders and Corporate Control," *Journal of Political Economy*, 94(3), 1986.

Shleifer, Andrei and Robert Vishny, "A Survey of Corporate Governance," *Journal of Finance*, 52(2):737-83, June, 1997.

### **D. Empirical Evidence on Enterprise Reform**

Pinto, Brian, Marek Belka, and Stefan Krajewski, "Transforming State Enterprises: Evidence on Adjustment by Manufacturing Firms," *Brookings Papers on Economic Activity*, 1:1993.

Earle, John, and Saul Estrin, "Employee Ownership in Transition," in R. Frydman, C. Gray, and A. Rapaczynski (eds.), *Corporate Governance in Central Europe and Russia*, Central European University Press, 1996.

Barberis, N., Maxim Boycko, Andrei Shleifer, and N. Tsukanova, "How Does Privatization Work? Evidence from the Russian Shops," *Journal of Political Economy*, 1996.

Frydman, Roman; Cheryl Gray; Marek Hessel, and Andrzej Rapaczynski, "When does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies," *Quarterly Journal of Economics*, 1999.

Groves, Theodore, Yongmiao Hong, John McMillan, and Barry Naughton, "Autonomy and Incentives in Chinese State Enterprises," *Quarterly Journal of Economics*, 109(1), 1994.

Li, Wei. "The Impact of Economic Reform on the Performance of Chinese State Enterprises, 1980-1989." *Journal of Political Economy*, October 1997, 105(5), pp. 1081-1106.

Xu, Xiaonian, and Yan Wang, "Ownership Structure, Corporate Governance, and Corporate Performance," *China Economic Review*, 1999.

### **E. Entrepreneurs and New Firms**

McMillan, John, and Christopher Woodruff, "Entrepreneurs in Economic Reform," *Journal of Economic Perspective*, 2001.

Johnson, Simon; John McMillan, and Christopher Woodruff, "Entrepreneur and the Ordering of Institutional Reform," *Economics of Transition*, 2000.

Jin, Hehui, and Yingyi Qian, "Public vs. Private Ownership of Firms: Evidence from Rural China," *Quarterly Journal of Economics*, August 1998, 113(3), pp. 773-808.

Johnson, Simon; John McMillan, and Christopher Woodruff, "Property Rights and Finance," mimeo, UC San Diego, 1999.

Besley, Timothy. "Property Rights and Investment Incentives: Theory and Evidence from Ghana." *Journal of Political Economy*. 103(5), 903-37, 1995.

## **III. Markets**

### **A. Theory of Informal Contract Enforcement**

Fudenberg, D. and J. Tirole, *Game Theory*, chapters 5 and 9, MIT Press, 1991.

Fudenberg, D. and E. Maskin, "The Folk Theorem in Repeated Games with Discounting or with Incomplete Information," *Econometrica*, 54, 533-554, 1986.

Kandori, Michihiro, "Social Norms and Community Enforcement," *Review of Economic Studies*, 59:63-80, 1992.

Greif, Avner, and Eugene Kandel, "Contract Enforcement Institutions: Historical Perspective and Current Status in Russia," in Edward P. Lazear (ed.), *Economic Transition in Eastern Europe and Russia: Realities of Reform*, Stanford, CA: Hoover Institution Press, 1995.

Milgrom, Paul, Douglass North, and Barry Weingast, "The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs," *Economics and Politics*, 2:1-23.

## **B. Contract Enforcement in Transition**

McMillan, John, "Contracts without Law," Section 9 in "Markets in Transition," in David Kreps and Kenneth Wallis (eds.), *Advances in Economics and Econometrics: Theory and Applications*, Cambridge: Cambridge University Press, 1996.

McMillan, John, and Christopher Woodruff, "Interfirm Relationships and Informal Credit in Vietnam," *Quarterly Journal of Economics*, 1999.

McMillan, John, and Christopher Woodruff, "Dispute Prevention without Courts in Vietnam," *Journal of Law, Economics, and Organization*, 2001.

McMillan, John, and Christopher Woodruff, "Private Order under Dysfunctional Public Order," *Michigan Law Review*, 98:8, pp. 2421-58, 2000.

Johnson, Simon; John McMillan, and Christopher Woodruff, "Courts and Relational Contracts," *Journal of Law, Economics, and Organization*, 2001.

Hendley, Kathryn, Peter Murrell, and Randi Ryterman, "Law, Relationship, and Private Enforcement: Transactional Strategies of Russian Enterprises," University of Maryland, mimeo, 1998.

## **C. Regulation of Markets**

Glaezer, Edward; Simon Johnson, Andrei Shleifer. "Coase vs. the Coasian." *Quarterly Journal of Economics*, 2000.

Morck, Randall K.; Bernard Yeung; and Wayne Yu. "The Information Content of Stock Markets: Why Do Emerging Markets Have Synchronous Stock Price Movements?" *Journal of Financial Economics*, 2000.

de Soto, Hernando. *The Other Path: The Invisible Revolution in the Third World*. New York: Harper & Row, 1989.

Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, "The Regulation of Entry," *Quarterly Journal of Economics*, 117, 1-37, 2002.

Botero, Juan, Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, "The Regulation of Labor," mimeo, 2003.

## **IV. The State**

### **A. The Role of the State and the Problem of Credible Commitment**

North, Douglass, and Robert Thomas, *The Rise of the Western World: A New Economic History*, Cambridge University Press, 1973.

North, Douglass. *Structure and Change in Economic History*, New York: Norton, 1981.

Stiglitz, Joseph. *Whither Socialism*, MIT Press, 1994.

Shleifer, Andrei; and Robert Vishny. "Perspectives on Government," chapter 1 in Shleifer and Vishny, *The Grabbing Hand: Government Pathologies and Their Cures*, Harvard University Press, 1998.

Frye, Timothy; and Andrei Shleifer, "The Invisible Hand and the Grabbing Hand," *American Economic Review*, May, 1997.

Johnson, Simon, Daniel Kaufmann, John McMillan, and Christopher Woodruff, "Why do Firms Hide? Bribes and Unofficial Activity after Communism," mimeo, Stanford Business School. 1999.

Aoki, Masahiko, Hyung-Ki Kim, and M. Okuno-Fujiwara (eds.), *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*, Oxford University Press, 1996. Introductory chapter.

Greif, Avner, Paul Milgrom, and Barry R. Weingast, "Coordination, Commitment, and Enforcement: The Case of the Merchant Guild," *Journal of Political Economy*, 102(4), 745-776, 1994.

Bai, Chong-En, David D. Li, Yingyi Qian, and Yijiang Wang, "Limiting Government Predation Through Anonymous Banking: A Theory with Evidence from China," Mimeo, Stanford Institute for Economic Policy Research, 1999.

Morduch, Jonathan; and Terry Sicular. "Politics, Growth, and Inequality in Rural China: Does It Pay to Join the Party?" *Journal of Public Economics*, 77, 331-356, 2000.

### **B. The Rule of Law**

North, Douglass and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *Journal of Economic History*, December, 1989.

Litwack, John, "Legality and Market Reform in Soviet-Type Economies," *Journal of Economic Perspectives*, 5:77-90, 1991.

Weingast, Barry, "Political Foundations of Democracy and the Rule of Law," *American Political Science Review*, 91:245-63, 1997.

Hay, Jonathan, and Andrei Shleifer, "Toward a Theory of Legal Reform," *European Economic Review*, April, 559-67, April, 1996.

Clarke, Donald, "The Creation of a Legal Structure for Market Institutions in China," in John McMillan and Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions*, University of Michigan Press, 1996.

### **C. Decentralization and Federalism**

Weingast, Barry R., "The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Growth," *Journal of Law, Economics, and Organization*, 11:1-31, 1995.

Qian, Yingyi, and Barry R. Weingast, "Federalism as a Commitment to Market Incentives," *Journal of Economic Perspectives*, 11(4):83-92, Fall, 1997.

Qian, Yingyi, and Barry R. Weingast, "China's Transition to Markets: Market-Preserving Federalism, Chinese Style," *Journal of Policy Reform*, 1:149-185, 1996.

Jin, Hehui, Yingyi Qian, and Barry Weingast, "Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style," Mimeo, Research Center for Economic Development and Policy Reform, Stanford University, 1999.

Zhuravskaya, Ekaterina, "Incentives to Provide Local Public Goods: Fiscal Federalism, Russian Style," Harvard University, mimeo, 1998.

Qian, Yingyi, and Gerard Roland, "Federalism and the Soft Budget Constraint," *American Economic Review*, December, 1998.

Qian, Yingyi, Gerard Roland, and Chenggang Xu, "Coordinating Changes in M-form and U-form Organizations," Stanford Institute for Economic Policy Research, 1998.

Maskin, Eric, Yingyi Qian, and Chenggang Xu, "Incentives, Information, and Organizational Form," *Review of Economic Studies*, 1999.

Berkowitz, Daniel, and Wei Li, "Decentralization in Transition Economies: A Tragedy of the Commons?" *Journal of Public Economics*, 2000.

### **D. Corruption**

Bardhan, Pranab. "Corruption and Development: A Review of Issues." *Journal of Economic Literature*, September 1997, XXXV, pp. 1320-46.

Shleifer, Andrei, and Robert Vishny, "Corruption," *Quarterly Journal of Economics*, August, 1993.

Shleifer, Andrei and Robert Vishny, "Pervasive Shortages under Socialism," *RAND Journal of Economics*, 1992.