

THE FIRM I

MPA 612: Economy, Society, and Public Policy

February 19, 2019

*Fill out your reading report
on Learning Suite*

PLAN FOR TODAY

Power and inequality

Firms

XYZ car sales

Owners, managers, and employees

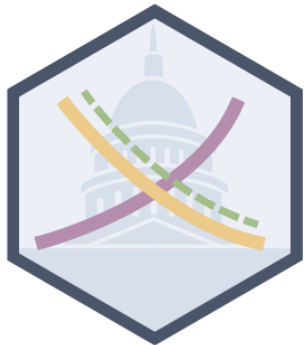
Capitalism, markets, and public policy

Growth Social dilemmas
Measurement Fairness

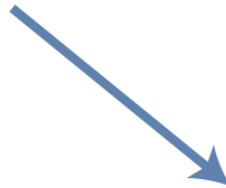


Scarcity, power, and inequality

Preferences Institutions Rights



ECONOMY, SOCIETY, AND PUBLIC POLICY



Evaluating and implementing policies

Cost-benefit analysis Experiments
Causal inference Politics



Market failures, governments, and politics

Externalities Public goods Rent seeking
Monopolies Government intervention



Economic models

Firms and markets Credit markets
Labor markets Macroeconomics

POWER AND INEQUALITY

GINI COEFFICIENT

0–1 scale

\$10,000

0 = Perfect equality

\$20,000

1 = Perfect inequality

\$50,000

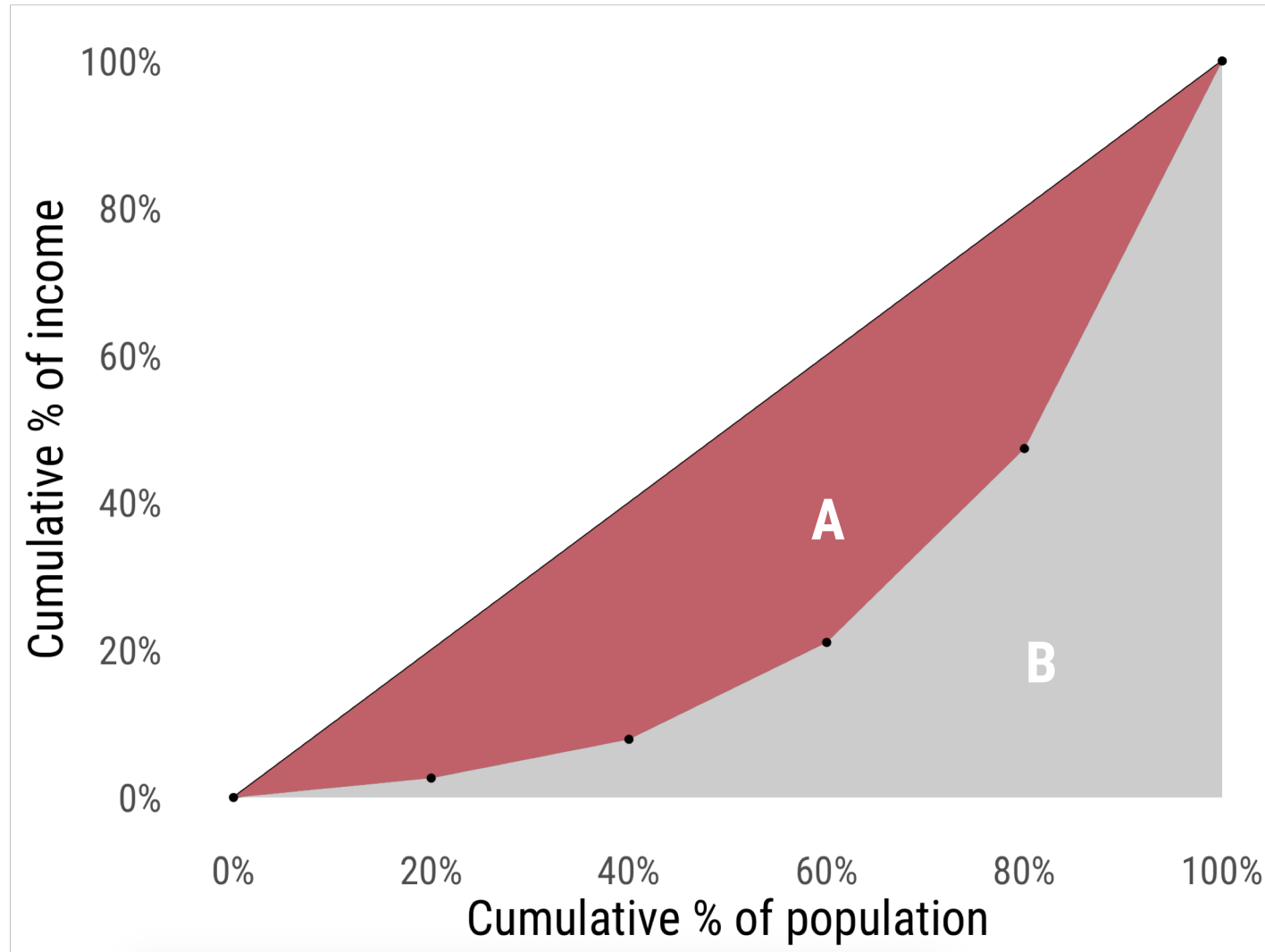
0.3ish = medium

\$100,000

0.5+ = high

\$200,000

GINI COEFFICIENT



$$\frac{A}{A + B}$$

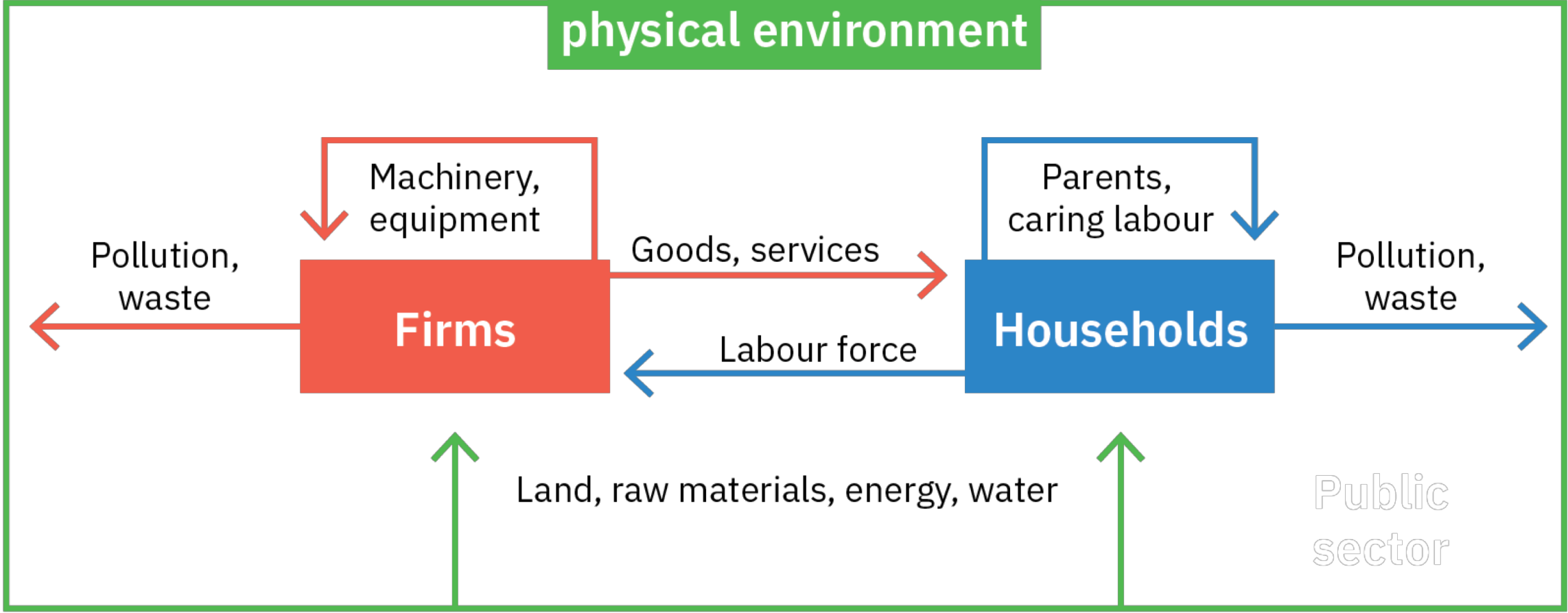
0.484

SHORTCUT

$$\frac{2}{\text{mean income}} \times \text{Cov}(\text{income, cumulative \% of population})$$

FIRMS

**Biosphere and
physical environment**



WHAT DO FIRMS DO?

Employ people

**Purchase inputs to provide
goods and services**

**Set prices higher than
cost of production**

HOW ARE DECISIONS MADE?

In markets

Choices emerge with no centralized planning

"[The market] is in fact a very Eden of the innate rights of man. There alone rule Freedom, Equality, Property."

Karl Marx, *Capital*, chapter 6

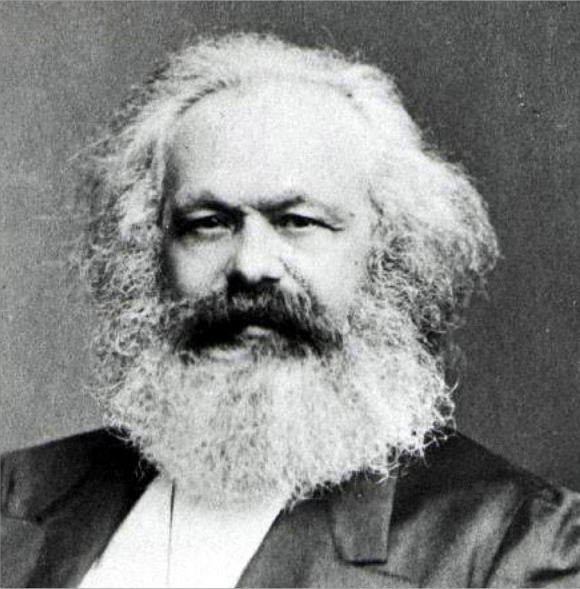
In firms

Decisions are centrally planned

"If a workman moves from department Y to department X, he does not go because of a change in prices but because he is ordered to do so."

Ronald Coase, "The Nature of the Firm"

CONSEQUENCES OF AUTHORITY



“The directing motive, the end and aim of capitalist production, is to extract the greatest possible amount of surplus-value, and consequently to exploit labour-power to the greatest possible extent.”

Karl Marx, *Capital*, chapter 13

CONSEQUENCES OF AUTHORITY



Costs of transacting in a market lead to the natural emergence of firms to deal with them. Firms make markets more efficient.

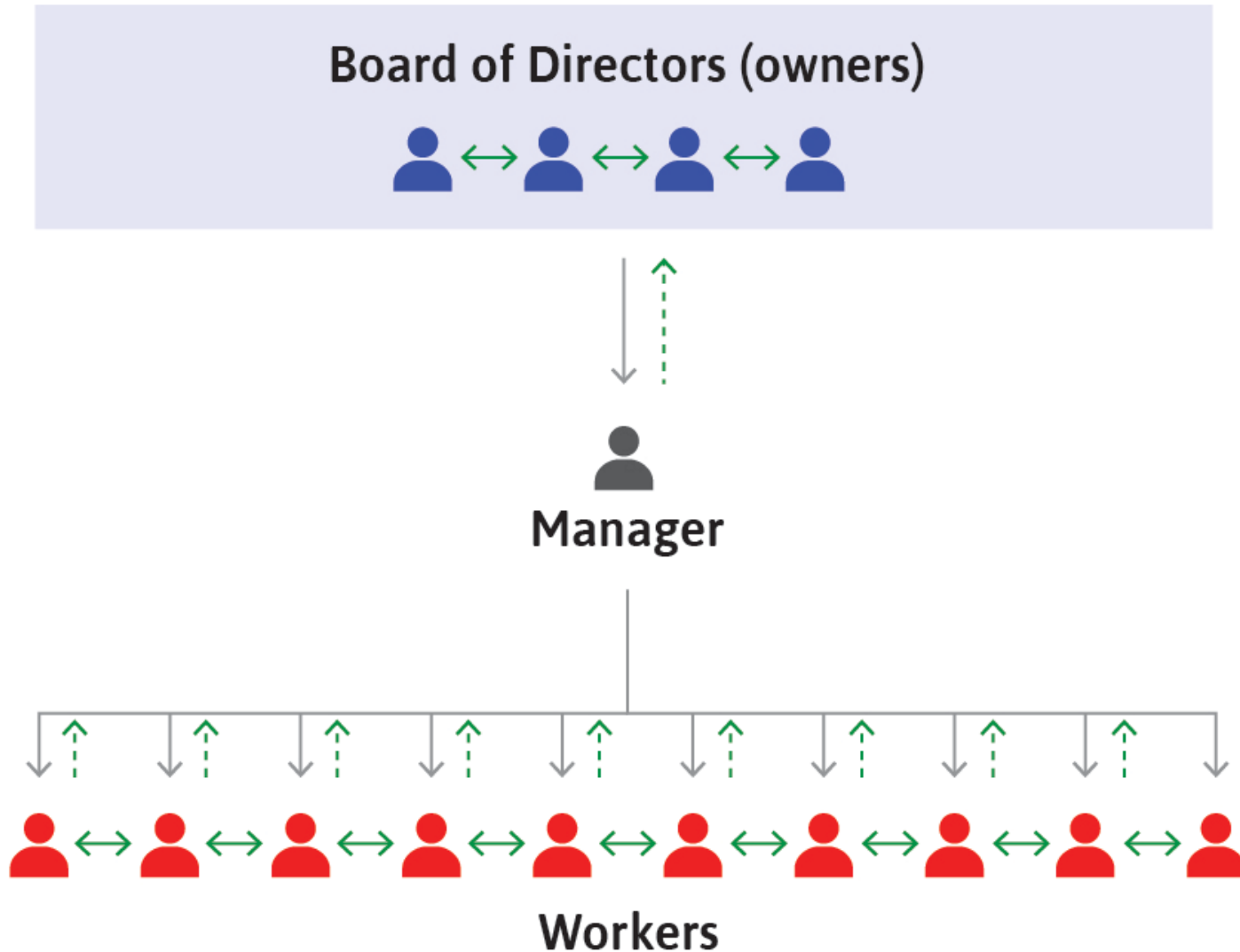
“The firm in a capitalist economy is a miniature, privately owned, centrally planned economy.”

ESPP 6.2

“...islands of conscious power in this ocean of unconscious cooperation”

D. H. Robertson, *The Control of Industry*

ORGANIZATIONAL STRUCTURES



Ownership?

Strategy?

Implementation?

Nonprofits?

Governments?

ORGANIZATIONAL STRUCTURES

**AMNESTY
INTERNATIONAL**



Proposal power

Enforcement power

Centralize

Implementation power

Decentralize

XYZ CAR SALES

Lemons are resold for \$500

Good cars are resold for \$2,500

$\approx 50\%$ of cars are lemons

ASYMMETRIC INFORMATION

Adverse selection

Hidden knowledge

Lemons

Insurance

Death spirals

Moral hazard

Hidden action

Repairs

Crime prevention

Reaching exact incentives

ASYMMETRIC INFORMATION

Adverse selection

Fix with screening

I'm going skydiving next week so I'll get insurance

Moral hazard

Fix with monitoring

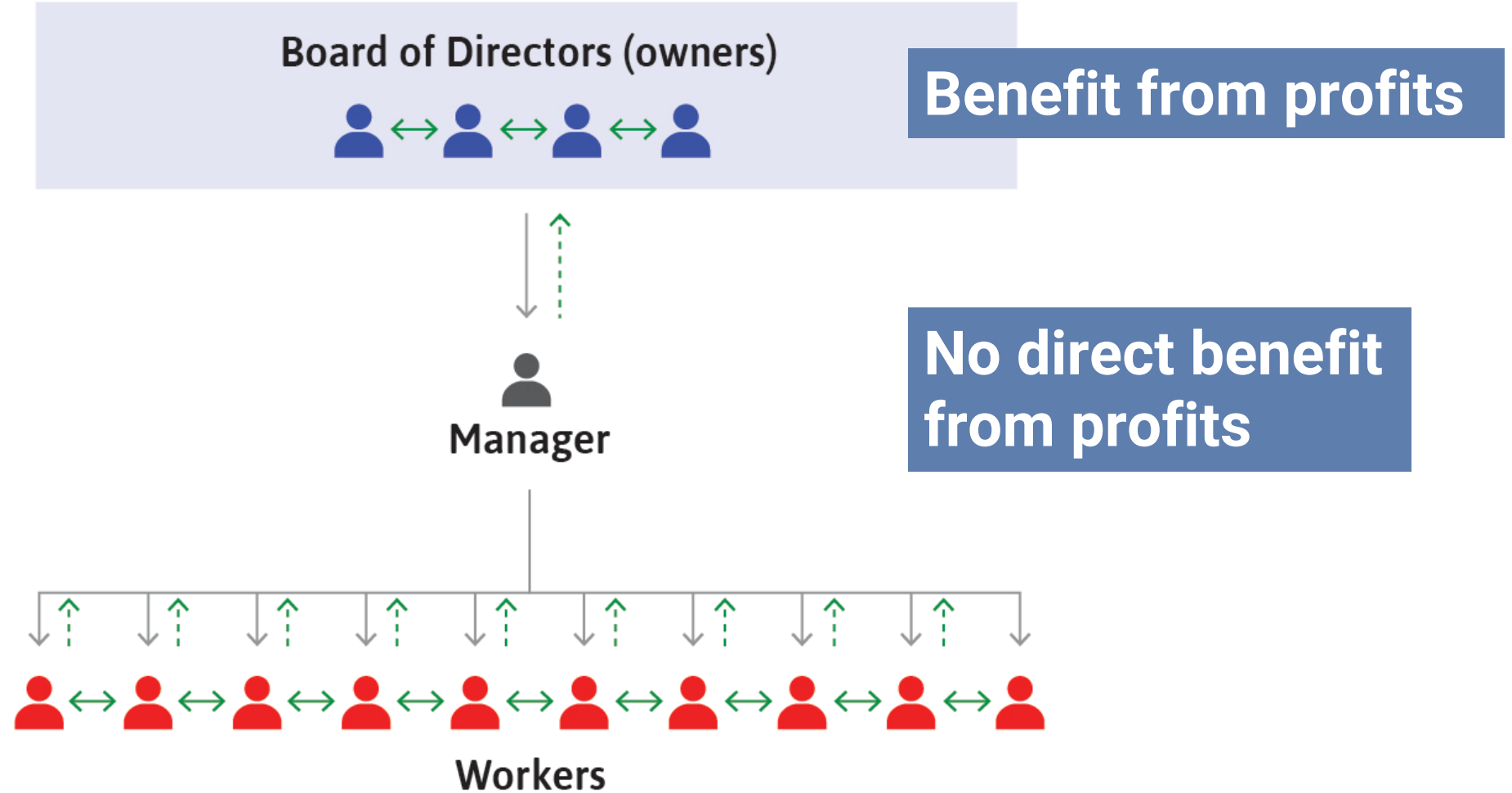
I have insurance so I'll take up skydiving

EXPLANATIONS GO BOTH WAYS

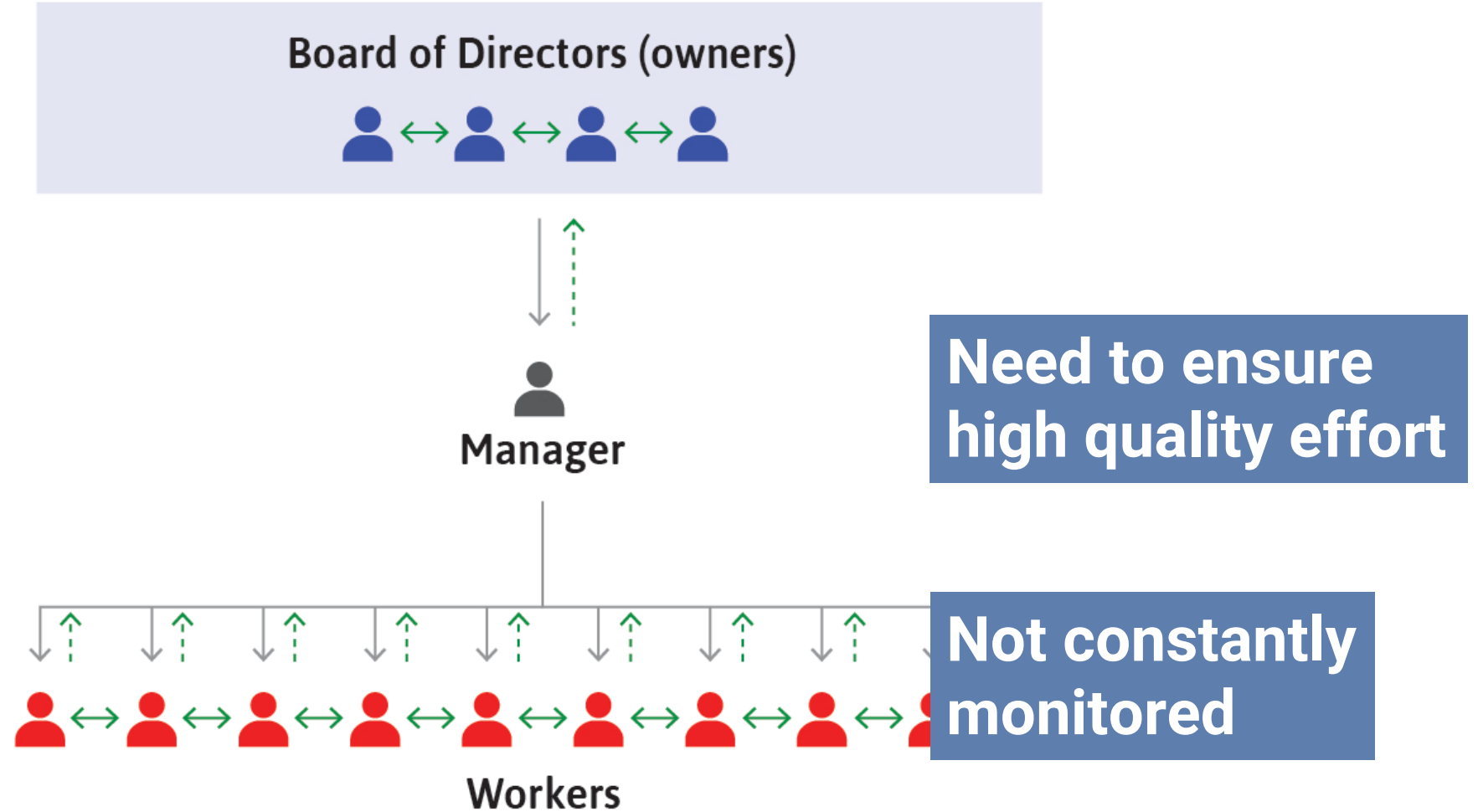


**OWNERS, MANAGERS,
AND EMPLOYEES**

CONFLICTS OF INTEREST



CONFLICTS OF INTEREST



How do you align everyone's interests?

Contracts!

A legal document or understanding that specifies a set of actions that parties to the contract must undertake

Temporary, limited transfer of authority
in labor markets