# MANAGERIAL ECONOMICS II: PERSONNEL ECONOMICS

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| Instructor | Jasmin Kantarevic, Ph.D. |
| Class Meetings | Tuesdays and Thursdays, 5-8pm, |
| | Room ES B149 (Earth Sciences Centre) |
| Course Web Site | www.jasminkantarevic.com/eco381 |
| Office Hours: | |
|   Regular | Tuesdays, 7-8pm, and by appointment |
|   Midterm | June 2, 5-7pm, BF 323 (Bancroft Building) |
|   Final | June 23, 5-7pm, BF 323 (Bancroft Building) |
| E-mail | jasmin.kantarevic@oma.org |

**Course Objective**
To provide you with a set of tools to design, evaluate, and compare alternative compensation models such as individual pay-for-performance, team-based compensation, and tournaments.

**Course Material**
All material related to the course will be posted on the course website. This material is based in part on the following three textbooks:

1. Lazear, Edward P. (1995) **"***Personnel economics***"** (MIT)
2. Garibaldi, Pietro. (2006) "*Personnel economics in imperfect labour markets"* (Oxford)
3. Milgrom, Paul R., and Roberts, John. (1992) "*Economics, organization, and management*" (Prentice-Hall)

For a less technical textbook presentation, see Lazear (1998), "Personnel Economics for Managers". For a more advanced review, see Prendergast (1999), "The provision of incentives in firms", *Journal of Economic Literature*, pp. 7-63.

The course material includes a set of ten <u>assignments</u>, with detailed worked-out solutions, posted on the course website. These assignments are not graded, but serve to prepare you for the graded components of the course (midterm and final exam).

I will be posting <u>course slides</u> on the course website. These slides are incomplete, and it is the students' responsibility to attend the class and take the notes, or, if they miss the class, to take notes from other students. I will not be posting the complete sides or sending them to students who did not attend the class.

**Prerequisites and Exclusions**
Prerequisites for this course are ECO200Y1/ECO204Y1/ECO206Y1;
ECO220Y1/ECO227Y1/(STA220H1,STA255H1)/(STA257H1,STA61H1). Prerequisites
are strictly checked and enforced and must be completed before taking a course. By
taking this course you acknowledge that you will be removed from the course at any time
if you do not meet all requirements set by the Department of Economics.
Exclusions: ECO370Y1.

**Grade Allocation**

|                | Weight     | Date              | Duration   |
|----------------|------------|-------------------|------------|
| Midterm        | 20 or 30%  | June 3, 5:10 PM   | 50 minutes |
| Research Paper | 20 or 30%  | June 19, 5:10 PM  |            |
| Final          | 50%        | Week of June 23-27 | 2 hours   |

*Weight on Midterm and Research Paper*
If the midterm is better than the research paper, the midterm counts out of 30 and the
paper counts out of 20. Conversely, if the midterm is worse than the research paper, the
midterm counts out of 20 and the paper counts out of 30.

*Time Conflict and Missed Midterm*
Given that the midterm is scheduled during the regular class time and announced on the
first day of the course, there will be no exceptions to writing the midterm at this time,
except for valid medical reasons.  The midterm is not optional. If you miss the midterm
test, you must provide appropriate documentation within one week of the actual midterm.
The appropriate documentation is an original University of Toronto Medical Certificate
(not scanned, copied, or e-mailed) that is fully completed by a medical doctor, including
the doctor's OHIP registration number.  Retroactive notes (i.e., student claims to have
been sick on the day of the test, but met doctor at a later date) or notes that indicate that
the student would have performed "sub-optimally" will not be accepted.  If you provide
the appropriate documentation, the final exam counts out of 70 and the research paper
counts out of 30.

*Research Paper*
The research paper consists of applying tools and principles you learn in the course to a
real world incentive problem of your choice.  Detailed descriptions are available in a
separate document that is posted on the course website.

*Deadline for Withdrawal*
The deadline for withdrawal is June 9, 2014.  The midterm marks will be posted on the
course website by June 8 to help you in this process.

*Re-grading Policy*

An appeal for a midterm re-grade must be typed (on paper, not e-mail) in great detail. You must specify exactly which item you believe was marked incorrectly, what you believe was marked incorrectly, what you believe your mark on that item should be, and why. To be considered, appeals must be turned in to me within <u>two</u> weeks of the date the midterm is handed back. Specifically, appeals received after June 17 will not be reviewed. You will then receive a written explanation of whether your request was granted or not and why. Note that your entire midterm will be re-graded and not only the question(s) you are appealing.

**Tentative Class Plan**

| Class | Topic | Textbooks (Optional) | Readings* (Required) |
|---|---|---|---|
| May 13 | Introduction | | |
| May 15 | Basic Incentive Contract | | |
| May 20 | Incentives and Insurance | | |
| May 22 | Risk Averse Agent | Garibaldi, pp.100-104 | |
| May 27 | Risk Neutral Agent | Lazear, pp. 13-19 | 1 |
| May 29 | Multiple Signals | Milgrom, pp. 214-221 | 2 |
| June 3 | MIDTERM | | |
| June 5 | Multiple Tasks | Milgrom, pp. 214-221 | 3 |
| June 10 | Subjective Evaluation | Bol, pp. 1-27 | 4 |
| June 12 | Non-Financial Incentives | Fehr, pp. 2-34 | |
| June 17 | Teams | Lazear, pp. 47-51 | 5 |
| June 19 | Tournaments | Lazear, pp. 25-37 | 6 |

**\* Readings:** Students are responsible for pages in square brackets after each reading.

1. Shearer, Bruce (2004) "Piece rates, fixed wages and incentives: evidence from a field experiment", *Review of Economic Studies*, 71, 513-534 [Sections 2-4, except 4.1].
2. Gibbons, Robert, and Kevin J. Murphy (1990) "Relative performance evaluation for chief executive officers", *Industrial and Labor Relations Review,* 43(3), 30S-51S [Section: Relative Performance and CEO Compensation, 36-42]
3. Hannaway, Jane (1992) "Higher order skills, job design, and incentives: an analysis and proposal", *American Educational Research Journal,* 29(1), 3-21 [All].
4. Kerr Steven (1975) "On the folly of rewarding A, while hoping for B", *Academy of Management Journal*, 18(4), 769-783 [769-775].
5. Knez Mark and Duncan Simester (2001) "Firm-wide incentives and mutual monitoring at Continental Airlines", *Journal of Labor Economics*, 19(4), 743-772 [Section II].
6. Becker Brian E. and Mark E. Huselid (1992) "The incentive effects of tournament compensation systems", *Administrative Science Quarterly*, 37, 336-350 [336-344].

**Academic Misconduct**

Students should note that copying, plagiarizing, or other forms of academic misconduct will not be tolerated. Any student caught engaging in such activities will be subject to academic discipline ranging from a mark of zero on the assignment, test or examination to dismissal from the university as outlined in the academic handbook. Any student abetting or otherwise assisting in such misconduct will also be subject to academic penalties.


**Learning Goals**

By the end of this course, you should be able to:

1. (Application and Analysis)
   Given a real-world incentive problem:
   a. Describe it in terms of a principal-agent framework.
   b. Define the best possible (i.e. efficient) outcome that can be achieved.
   c. Propose an optimal contract when there is asymmetric information between the principal and the agent.
   d. Communicate your proposal effectively to a non-technical audience.

2. (Problem Solving)
   Given a specific mathematical model of the principal-agent relationship:
   a. Apply concepts and principles learned in the course to find an optimal contract.

3. (Empirical Evaluation)
   Given an empirical evaluation problem and one of three empirical methods (multivariate regression, randomized experiments, and difference-in-differences):
   a. Define the hypothesis to be tested and how it relates to theory.
   b. Define treatment, treatment group, control group.
   c. Identify assumptions needed to strengthen inference about the causal impact of treatment.
   d. Interpret the results (e.g. the statistical and economic significance of estimates; the relation between the results and specific theoretical predictions).