

Organization and Market Economics

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The course

This course is a gentle introduction to the organization and coordination of economic activities through the market, within firms, and through the strategic interactions between firms in a market economy. Put differently, we analyze not only what happens within a market but also what happens inside firms. Modules I-VI pertain to the conduct of economic activity through the market, with particular emphasis on the economic way of thinking about demand and supply within partial and general equilibrium settings. For the purposes of analytical simplicity, Modules I-VI assume that the market is populated with a large number of autonomous agents pursuing their own goals, with the necessary implication that though prices emerge from the decisions of individual agents, no individual agent has a significant effect on any price. Modules I-VI also assume there are no non-price external effects that follow from production and consumption activities. Modules VII and VIII relax these stringent assumptions to analyze the economic structures that emerge in a world with external effects and price determination by a small number of agents. Modules IX and X develop motivations for why certain economic activities are organized and coordinated within organizations rather than through markets. Modules XI and XII use elementary game theoretic notions to analyse strategic interactions between a small number of firms, including leader-follower dynamics.

Study materials

Each module contains a video, a case, and a set of readings. The readings consist of chapters from textbooks and journal articles. The textbooks used in the course are listed below Alchian & Allen's *Exchange & Production*, Pindyck & Rubinfeld's *Microeconomics*, and Varian's *Intermediate Microeconomics*. Varian and Pindyck & Rubinfeld are reasonable substitutes, with Varian being my preferred book. Alchian & Allen offers an information-theoretic and property-rights view of microeconomic theory. None of these books are a substitute for Mises's Magnum Opus *Human Action*, which is a good read for those interested in the fundamentals of economic thinking. We use Alpha C Chiang's *Fundamental Methods of Mathematical Economics* for the mathematical preliminaries required for this course. More adventurous amongst you may like to consult Rangarajan K Sundaram's *A First Course in Optimization Theory*.

Class notes and my approach to teaching

A teacher of mine used to say 'You don't take a course, you take a Professor'. Some Professors may look upon a course as a part of a 'teaching load' to be unloaded through varied renditions of the materials printed in one textbook or another. Note that these textbooks themselves are standardized (read 'dumbed down') variants of certain ideas and notions. Such an approach to teaching is an unwholesome waste of my time and a gross disrespect to students, for students are capable of reading and understanding textbooks on their own. My own approach to teaching is more akin to working our way up a mountain, with my role being that of a guide. The textbooks and other readings prescribed in the syllabus are tools useful for the journey. One may even view some of the readings as maps—albeit incomplete, conflicting, and sometimes erroneous—that depict the mountains upon which we wish to climb. Note that it is upto you to decide how to use the tools and maps at our disposal. And it is precisely in making this decision that the course becomes unique, meaningful, and sensible. Some of our journey can be documented through class notes, which will prove to be useful preparatory material for examinations. Though I must hasten to add that class notes, not matter how copious, is no substitute for your experience of having been in class, for having applied your mind, for having charted your own way up the mountain.

I The economic way of thinking

Video [Tyler Cowen on Discover Your Inner Economist](#)

Case: Why do fans who travel the farthest purchase the best football tickets?

- Bertonazzi, Eric P., Michael T. Maloney, and Robert E. McCormick. 1993. "Some evidence on the Alchian and Allen theorem: The third law of demand?" *Economic Inquiry*, 31(3): 383-393.

Readings

- Alchian and Allen, Chapter 1.
- Bastiat, Fredric. 1848. The Seen and the Unseen.
- Becker, Gary S. 1993. "Nobel lecture: The economic way of looking at behavior." *Journal of Political Economy*, 101(3): 385-409.
- Read, Leonard E. 1958. "I, Pencil: My Family Tree". The Foundation for Economic Education.

II Optimization theory: elementary ideas

Video [A gentle introduction to optimization](#)

Case: Why do 'rational' rats choose to have more quinine when the 'price' of quinine increases relative to the 'price' of root bear?

- Battalio, Raymond C., John H. Kagel, and Carl A. Kogut. 1991. "Experimental confirmation of the existence of a Giffen good." *The American Economic Review*, 81(4): 961-970.

Readings

- Chiang, Alpha C. Year. *Fundamental Methods of Mathematical Economics*, Third Edition. Chapters 9 and 11-12.

III Theory of demand

Video [Ronald Coase and Gary Becker on The Theory of Consumer Behavior](#)

Case: Why do 'rational' rats choose to have more quinine when the 'price' of quinine increases relative to the 'price' of root bear?

- Battalio, Raymond C., John H. Kagel, and Carl A. Kogut. 1991. "Experimental confirmation of the existence of a Giffen good." *The American Economic Review*, 81(4): 961-970.

Readings

- Alchian and Allen, Chapter 2.
- Pindyck and Rubinfeld, Chapters 2-4.
- Varian, Chapters 2-7.

IV Theory of supply

Video [Don Boudreaux on Comparative Advantage](#)

Case: Why don't people respond to higher wages by working more?

- Kimball, Miles S., and Matthew D. Shapiro. 2008. "Labor supply: Are the income and substitution effects both large or both small?". *NBER Working Paper No. 14208*.

Readings

- Alchian and Allen, Chapters 3, 5, and 7.
- Pindyck and Rubinfeld, Chapters 6-9
- Varian, Chapters 21-23 and 32.

V Walrasian General Equilibrium and the Welfare Theorems

Video [Israel Kirzner on Competition & Entrepreneurship](#) and [Gerard Debreu on Economic Theory \(four lectures\)](#)

Case: Modeling the loss in output due to COVID lockdowns within a general disequilibrium model

- Mandel, Antoine, and Vipin Veetil. 2020. "The economic cost of COVID lockdowns: an out-of-equilibrium analysis." *Economics of Disasters and Climate Change*, 4(3): 431-451.

Readings

- Hahn, Frank. 1980. "General Equilibrium Theory". *The Public Interest*: 123-138.
- Pindyck and Rubinfeld, Chapter 16.
- Varian, Chapter 31.

VI The emergence of prices and coordination

Video [Vernon Smith on Market as a Discovery Procedure within the Laboratory](#)

Case: The role of market prices in the post war German economic miracle

- Henderson, David R. 2008. "German Economic Miracle." *The Concise Encyclopedia of Economics*.

Readings

- Alchian and Allen, Chapter 4.
- Hayek, Friedrich A. 1968 (2002). "Competition as a discovery procedure". *Quarterly Journal of Austrian Economics*, 5(3): 9-23.
- Lavoie, Donald. 1985. "Coordination in society". In *National Economic Planning: What is left?* Ballinger Publishing Company.
- Varian, Chapter 37.

VII Externalities, the Coase Theorem, and the Demsetz Conjecture

Video [Alex Tabarrok on The Coase Theorem](#)

Case: Internalising externality through the World Carbon Market

- Wara, Michael. 2007. "Is the global carbon market working?." *Nature*, 445(7128): 595-596.
- World Bank. 2021. "[State and Trends of Carbon Pricing 2021](#)".

Readings

- Coase, Ronald H. 1960. "The problem of social cost." *The Journal of Law and Economics*, 3: 1-44.
- Demsetz, Harold. 1967. "Towards a theory of property rights. *The American Economic Review Papers and Proceedings*, 57(2): 347-359.
- Pindyck and Rubinfeld, Chapter 18.
- Varian, Chapters 34 and 36.

VIII Market structure

Video [Milton Friedman on Monopoly](#)

Case: European Competition Commission fined Heineken, Grolsch and Bavaria for 'operating a cartel'.

- [Website of the European Commission: 'Competition Commission fines members of beer cartel in The Netherlands over Euros 273 million'](#)

Readings

- Alchian and Allen, Chapters 11-13.
- Baumol, William J. 1983. "Contestable markets: an uprising in the theory of industry structure." *The American Economic Review*, 72(1): 1-5.
- Pindyck and Rubinfeld, Chapter 10-11 and Chapter 17.
- Varian, Chapters 24-26.

IX Game theory: elementary ideas

Video [Ariel Rubinstein on Conflict and Game Theory](#)

Case: Cold War and Game Theory

- Hagemann, Harald, Vadim Kufenko, and Danila Raskov. 2016. "Game theory modeling for the Cold War on both sides of the Iron Curtain." *History of the Human Sciences*, 29(4-5): 99-124.

Readings

- Pindyck and Rubinfeld, Chapters 12-13.
- Varian, Chapter 28-29.

X Strategic games between a small number of firms: duopoly, oligopoly, and monopolistic competition

Video [Benjamin Polak on Game Theory](#)

Case: Stackelberg competition in the mid-sedan automotive market in the US

- Roy, Abhik, Dominique M. Hanssens, and Jagmohan S. Raju. 1994. "Competitive pricing by a price leader." *Management Science*, 40(7): 809-823.

Readings

- Hildenbrand, Andreas. 2010. "Cournot or Stackelberg competition? A survey of experimental research." *CORE Working Paper*.
- Hotelling, Harold. 1929. "Stability in Competition." *The Economic Journal*, 39(152): 41-57.
- Varian, Chapter 27 .

XI 'Theory of the firm' or 'why organizations' or 'when vertical integration'

Video [Coase on Markets, Firms and Property Rights](#)

Case: The acquisition of Fisher Body by General Motors

- Goldberg, Victor P. 2008. "Lawyers asleep at the wheel? The GM-Fisher Body contract." *Industrial and Corporate Change*, 17(5): 1071-1084.

Readings

- Alchian, Armen A, and Harold Demsetz. 1972. "Production, information costs, and economic organization." *The American Economic Review*, 62(5): 777-795.

- Coase, Ronald. 1937. "The nature of the firm." *Economica*, 4(16) :386-405.
- Williamson, Oliver E. 2002. "The theory of the firm as governance structure: from choice to contract." *Journal of Economic Perspectives*, 16(3): 171-195.
- Veetil, Vipin P. 2022. "Distributed knowledge and the organization of economic activity." *Computational and Mathematical Organization Theory*, 28(2): 95-111.

XII 'Theory of the bureaucratic organization of economic activity' or 'inside organizations'

Video [Eric Maskin on Mechanism Design Theory](#)

Case: The bureaucratic organization of economic activity in the Soviet Union: Procedures for collecting information, making decisions, and relaying commands.

- Frank, Andrew Gunder. 1957. "The Organization of Economic Activity in the Soviet Union." *Weltwirtschaftliches Archiv*, 78: 104-156.

Readings

- Bolton, Patrick, and Joseph Farrell. 1990. "Decentralization, duplication, and delay." *Journal of Political Economy*, 98(4): 803-826.
- Sah, Raaj Kumar, and Joseph E. Stiglitz. 1984. "The architecture of economic systems: Hierarchies and polyarchies." *NBER Working Paper No. 1334*.
- Veetil, Vipin P. 2017. "Coordination in centralized and decentralized systems." *International Journal of Microsimulation*, 10(2): 86-102.