open.michigan

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UNIVERSITY OF MICHIGAN

Playlist

“Conflict of Interest”, Binky Mack

“Disagree”, Chantal Kreviazuk

“Hide and Seek”, Ani di Franco

“Did You Get My Message?”, Jason Mraz

“Joint Venture”, Staffan William-Olsson

“Silent Agency”, Silent Agency

Hidden Action I

Information professionals need to manage many resources to succeed.

Information professionals need to manage many resources to succeed. Including people.

Agents use your expensive resources, but you can’t always monitor what they do

You must learn to manage *without control*.

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You succeed if your independent agents *want* to solve *your* problems.

Design agreements that *motivate* agents to *self-monitor*.

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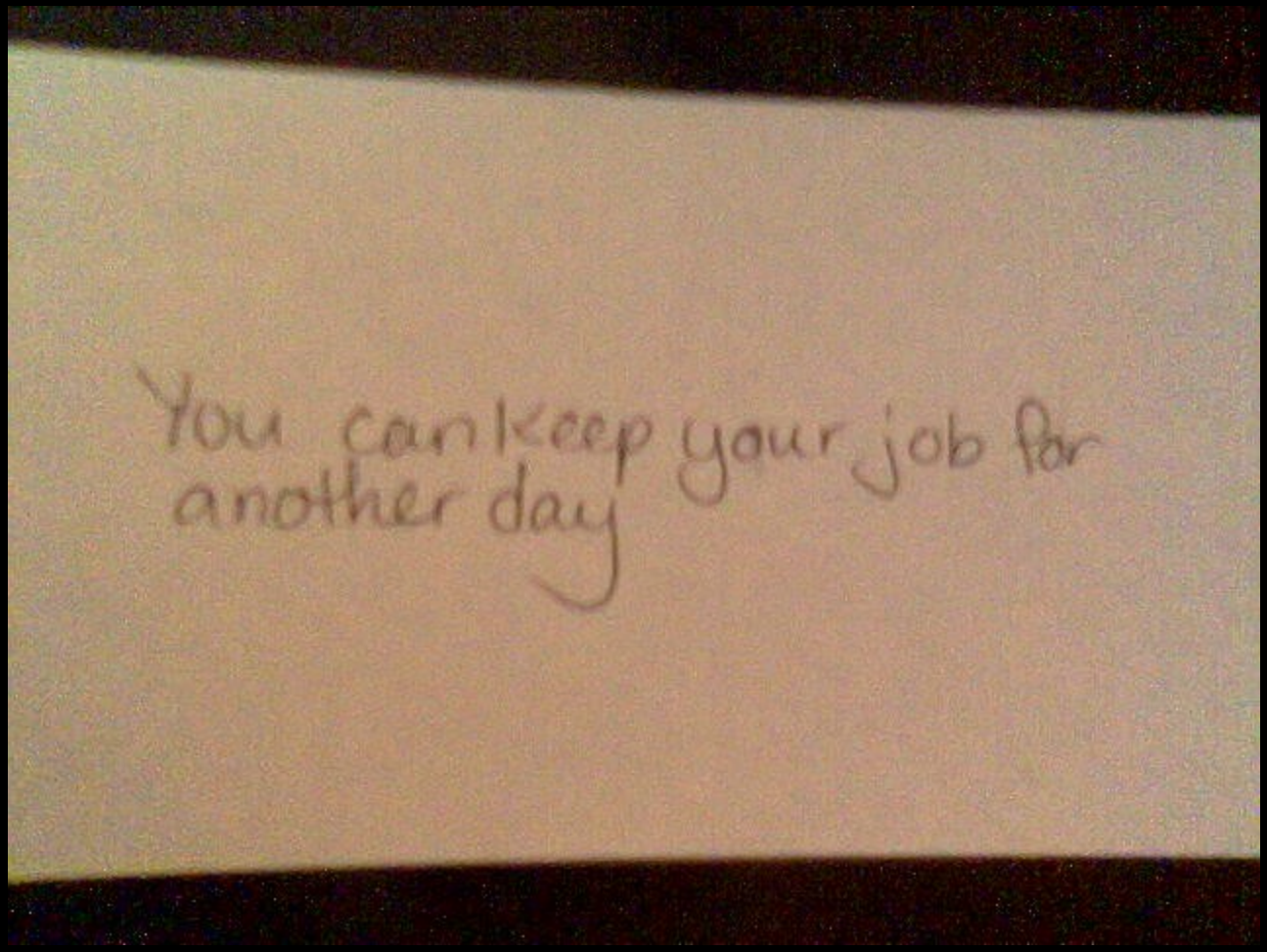

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Perfect contracts with perfect information can solve this problem.

Contract

The party of the first part and the party of the second part hereby agree that:

If x1 happens, do y1, get paid z1;
If x2 happens, do y2, get paid z2;
If x3 happens, do y3, get paid z3…

Elmer Fudd

Elmer Fudd, Esq. Alfred E. Newman

Death penalty for parking violations

Ines Macho-Stadler and J. David Perez-Castrillo, *An Introduction to Economics of Information: Incentives and Contracts*, 2nd ed. (Oxford University Press, 2001), pg 281.

<example>

ebaY

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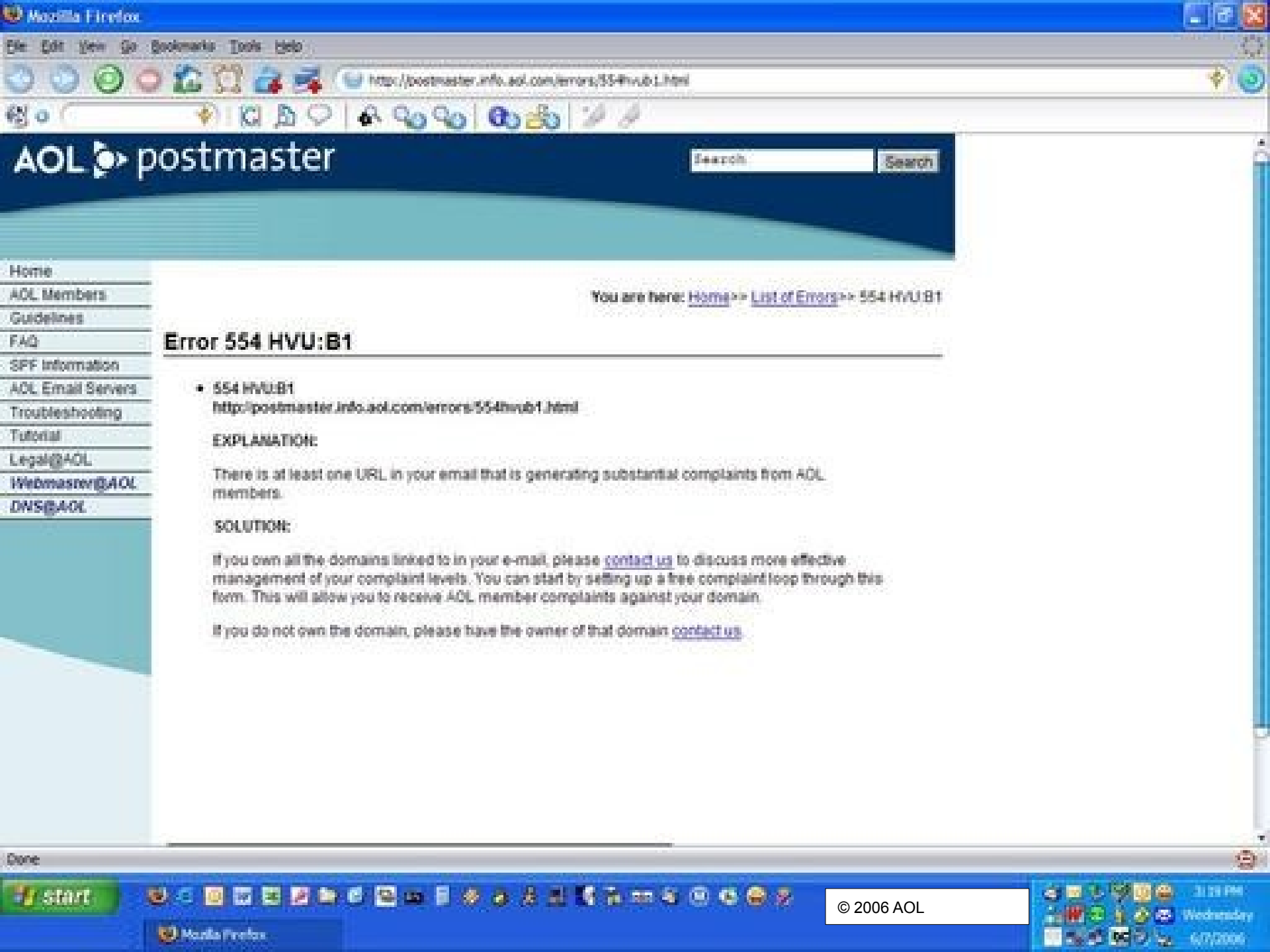
Do you trust this seller?


Mozilla Firefox
File Edit View Go Bookmarks Tools Help
http://postmaster.info.aol.com/errors/554hvub1.html
AOL postmaster
Search
Search
Home
AOL Members
Guidelines
FAQ
SPF Information
AOL Email Servers
Troubleshooting
Tutorial
Legal@AOL
Webmaster@AOL
DNS@AOL
You are here: Home>> List of Errors>> 554 HVU:B1
Error 554 HVU:B1
554 HVU:B1
http://postmaster.info.aol.com/errors/554hvub1.html
EXPLANATION:
There is at least one URL in your email that is generating substantial complaints from AOL members.
SOLUTION:
If you own all the domains linked to in your e-mail, please contact us to discuss more effective management of your complaint levels. You can start by setting up a free complaint loop through this form. This will allow you to receive AOL member complaints against your domain.
If you do not own the domain, please have the owner of that domain contact us.
Done
start
Mozilla Firefox
3:19 PM
Wednesday
6/7/2006

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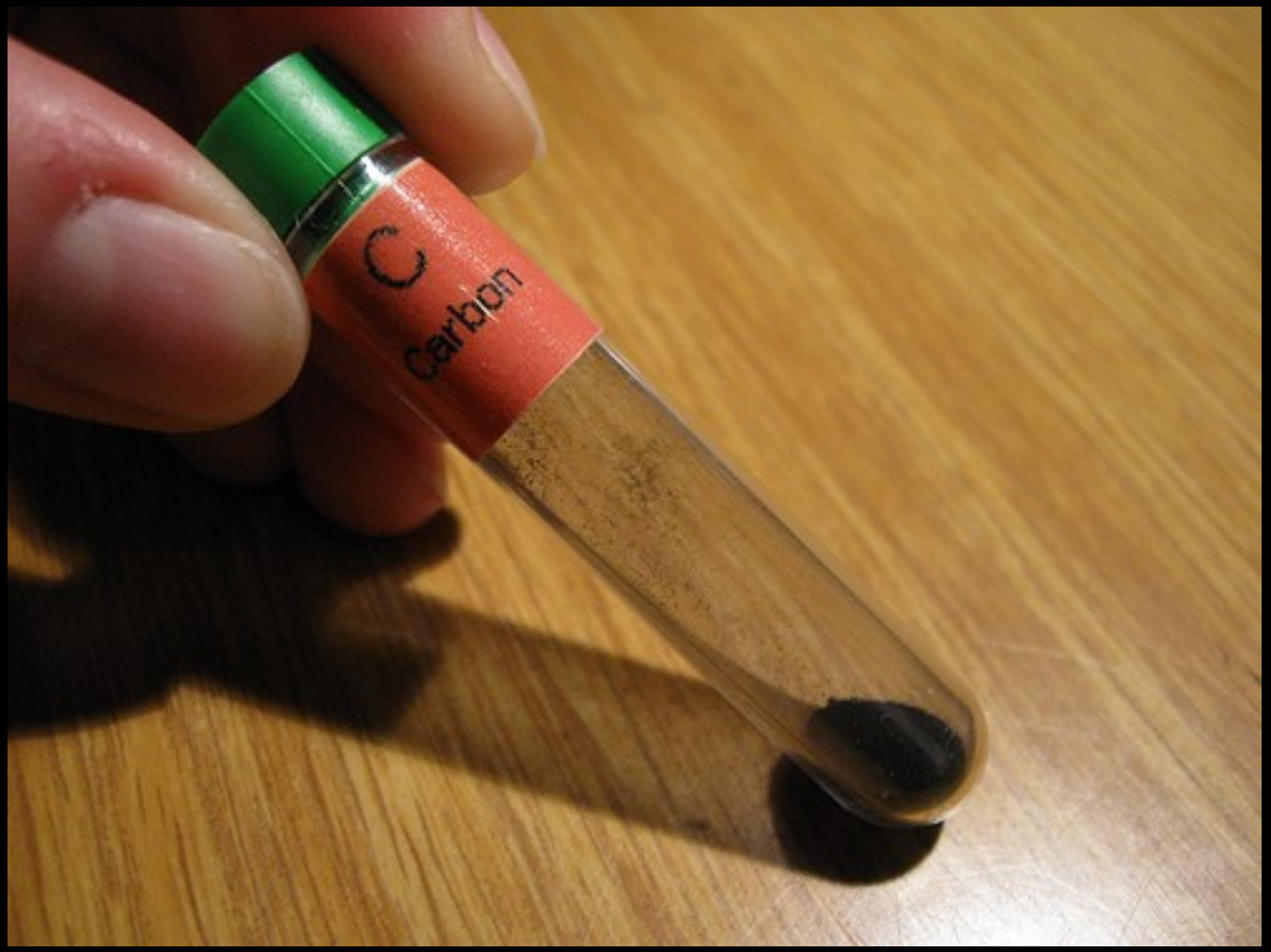
The information requirements for perfect contracting are prohibitive.

bounded rationality

memory

communication

computation



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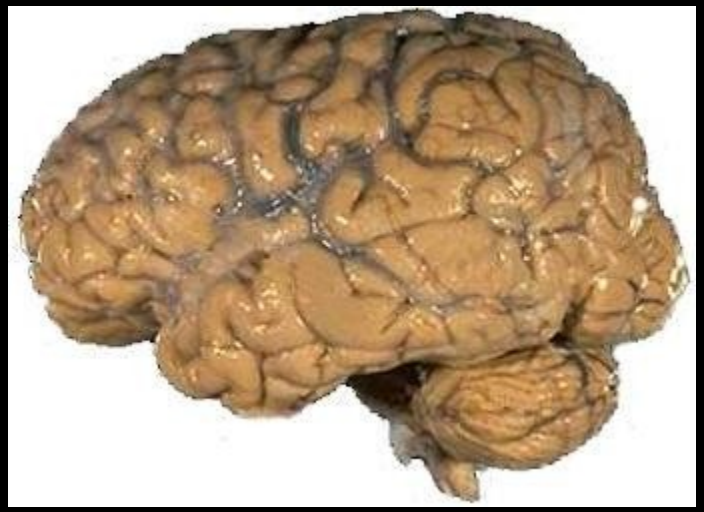

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silicon-based

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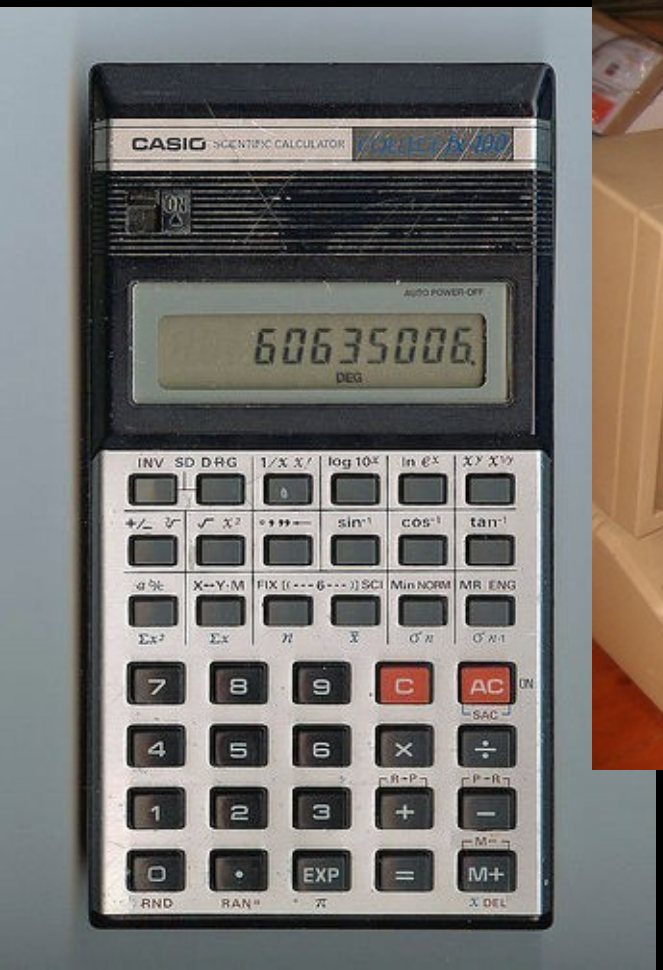

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What are some solutions?

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commitment

Xiang Yu

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Photo tour of factory: http://forums.vwvortex.com/zerothread?id=1837641

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contracts

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Gabor Varszegi

fotex

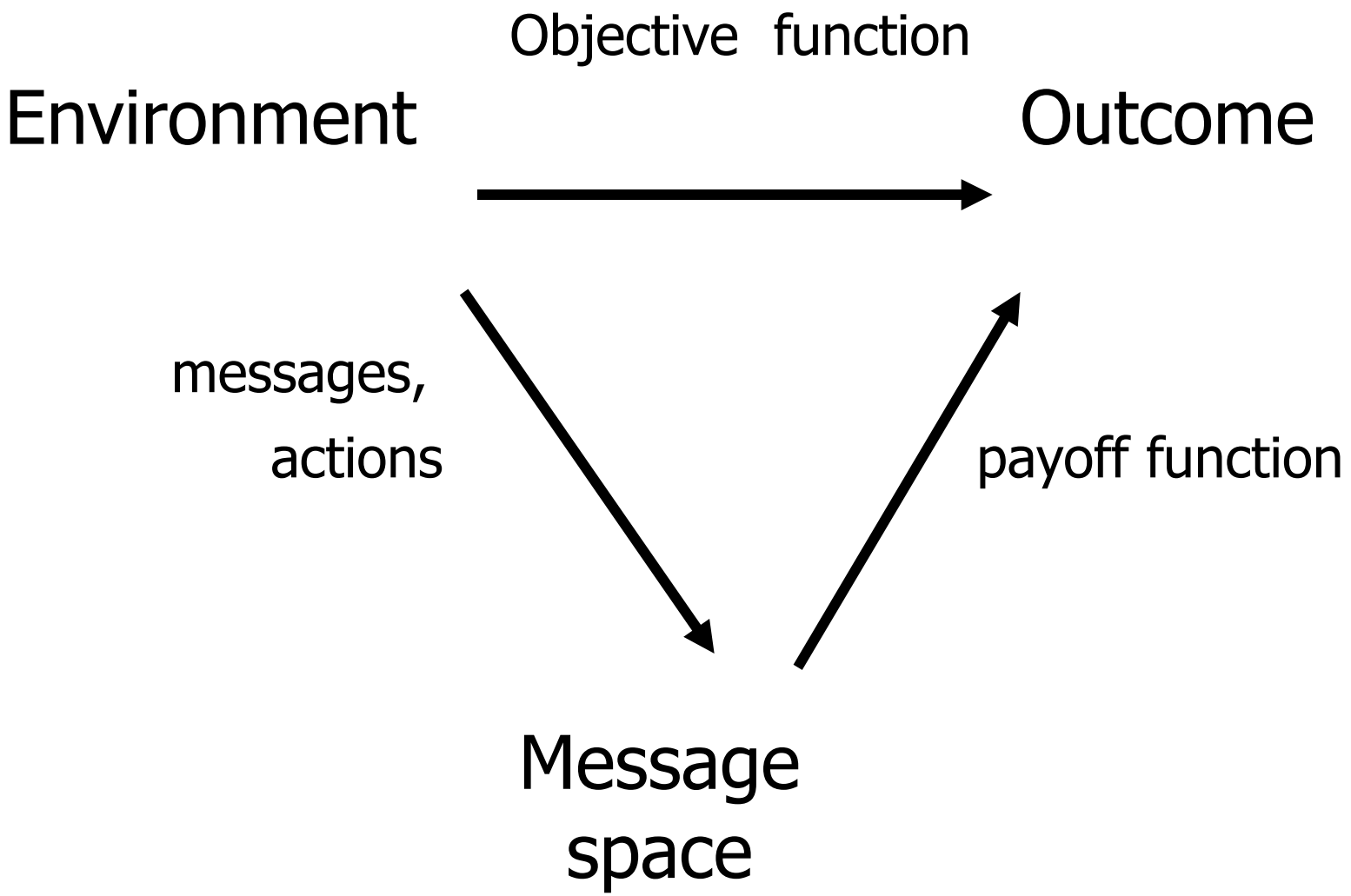
pay 4x the market wage

Canonical contracting problem

Principal contracts with *agent* to carry out some type of action or make some decision

- *principal* designs and offers the contract(s)
- *agent* freely chooses whether to accept (IR)
- *agent* performs, but has some information not available to *principal*

Mount-Reiter diagram



Canonical contracting problem

Principal contracts with *agent* to carry out some type of action or make some decision

NB: Fundamental conflict of interest:
Cost for one is benefit for other.

NB: Verifiability is critical issue:
What is enforceable?

1. Agency cost

When principals and agents have conflicting objectives, and asymmetric info…

- …Can't expect the organization or community (etc.) to function as well as it would with full information or aligned objectives

Shortfall: *agency cost*

2. Information rent

Principal transfers part of surplus to agent to overcome agency cost: this is the agent's *compensation.*

Compensation =

reservation utility + ***information rent***

<example>

Dissolving a joint venture

How to agree on price for a departing participant?

2 agents, self-regarding, monotonic preferences:
prefer x_i to y_i iff $x_i > y_i$

Message space:
vi, announced valuation for share.

Problem: How to decide payment given the vi?

What's wrong with the following mechanisms?

Departing partner announces her v_i at departure date.

Partner has to buy her out at that price

Agree on buyout price at contract commencement date.

Departee announces v_i at departure date.

Partner chooses to buy at that price, or sell his half to departee at same price.

Proof of incentive compatibility

Suppose share is worth w to both partners (but they don't know the value to the other)

- If you announce v>w, partner will sell to you for v, you will lose
- If you announce v<w, partner will buy from you for v, you will lose
- Announce v=w: partner willing to buy from you, get full value

Pareto optimal

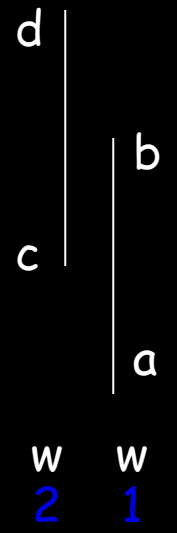
Everyone at least as well off as before, no one worse

No other result is Pareto superior

Cf. Pre-nuptial agreements

But, not so fast…

What if the partners have different beliefs about the true value?

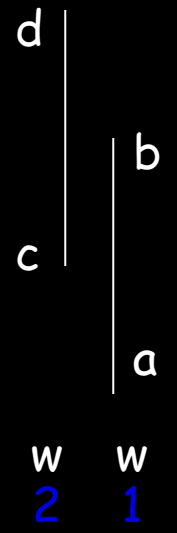


- Suppose $w_1 \in [a,b]$, and $w_2 \in [c,d]$ with $a<c<b<d$ (overlapping intervals)
- What problem occurs with proposed mechanism?

2

1

But, not so fast…



What if the partners have different beliefs about the true value?

- Suppose $w_1 \in [a,b]$, and $w_2 \in [c,d]$ with $a<c<b<d$ (overlapping intervals)
- What problem occurs with proposed mechanism?
  - Depending on beliefs about w2, seller might want to bid v > w1, risking having to buy other share at higher price, but hoping to sell own share at higher price

Discussion

- In this setting (bilateral trade with overlapping value supports) *no mechanism can guarantee* that its outcome will be:
  - efficient
  - budget balanced
  - individually rational

- For example, for any mechanism there might be cases where $w_2 > w_1$, so there is some price at which both parties are better off if one partner sells to the other, but for which trade will not occur: Myerson-Satterthwaite (1981)

<summary>

Humans are crucial devices in any system.

They are autonomous and (generally) at least somewhat self-interested.

Most tasks that require cooperation or agency (effort on behalf of someone else) have intrinsic conflict of interest.

Conflict of interest

Not swear words.

Learn to love them.

They create an opportunity for smart ICD professionals:
Problems to solve.