

Relationships in the Wild

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Discussion by

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The Question

Ambitious and policy-relevant question:

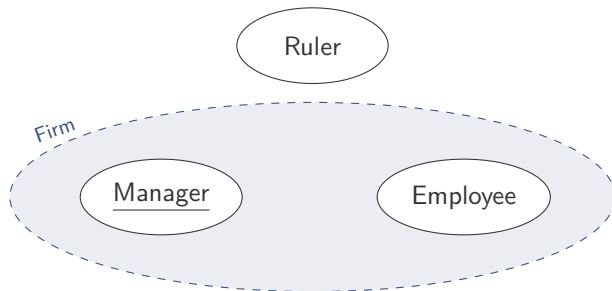
- ▶ How strength of **political institutions** shapes optimal **firm governance**

what is governance?

What is Private Governance?

model

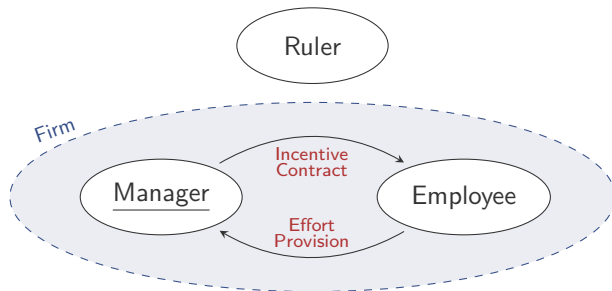
Under **private** governance, Manager owns output and has contracting power



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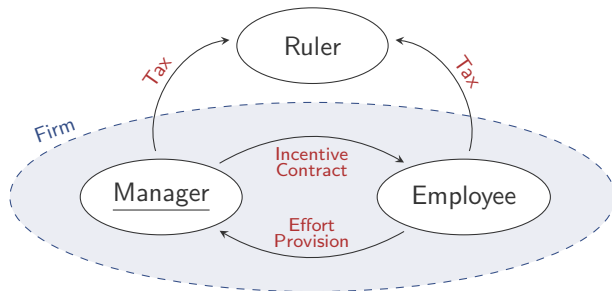
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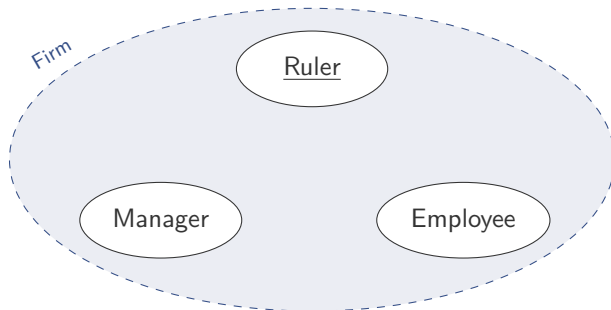
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What is State Governance?

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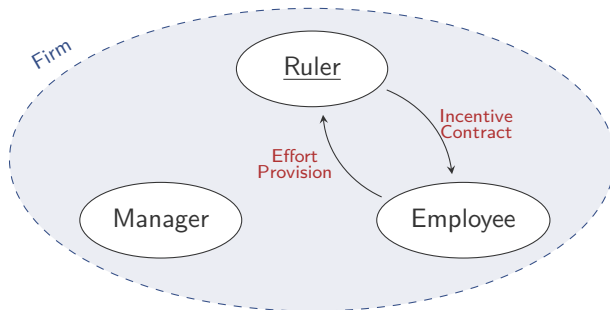
Under **state** governance, Ruler owns output and has contracting power



What is State Governance?

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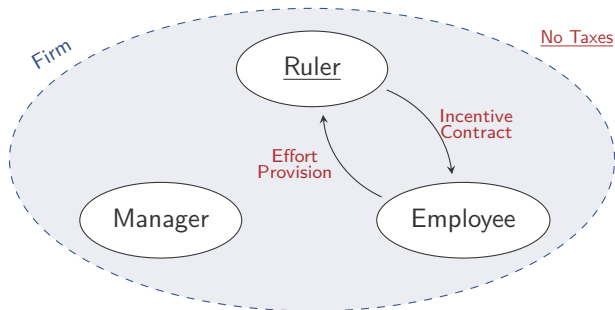
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What is State Governance?

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Under **state** governance, Ruler owns output and has contracting power



what are institutions?

Each period, she can renege on her promises

Under **private** gov, Ruler can tax you more than promised

Under **state** gov, Ruler can pay you less than promised

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If ruler reneges, she is ousted with prob τ and otherwise remains in power

- High $\tau \Rightarrow$ **Strong** institutions \Rightarrow Low incentives to expropriate
- Low $\tau \Rightarrow$ **Weak** institutions \Rightarrow High incentives to expropriate

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If τ is high, **private** governance and high-powered incentives are optimal

If τ is low, **state** governance and flat incentives are optimal

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Comments

- + Excellent paper!
- + A crafty modeling exercise
- + It interacts two dimensions often studied in isolation
- + Opens an interesting future agenda: more interactions?

what else can be done?

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Under **private** gov, Value of Reneging = $(1 - \tau) \left(\Pi + \frac{\delta}{1 - \delta} \pi \right)$

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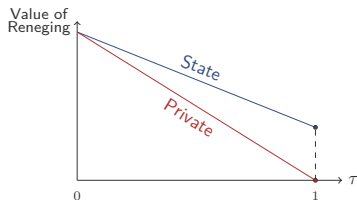
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Reneging is less attractive under private gov, which thus has advantage at high-pwr contracts

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- Easier to renege on a due payment than changing tax code

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Yet, it's a subtle detail rather than a fundamental force

Q. Can you do without it?

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A somewhat nonstandard assumption: its impact on result is subtle

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There could be scope to make mechanism even simpler and more transparent

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thanks!