Relationships in the Wild

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Discussion by

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The Question

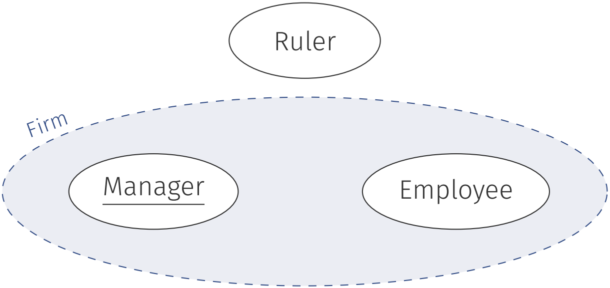
Ambitious and policy-relevant question:

- How strength of political institutions shapes optimal firm governance

what is governance?

What is Private Governance?

In a **private** firm, Manager owns output and has contracting power



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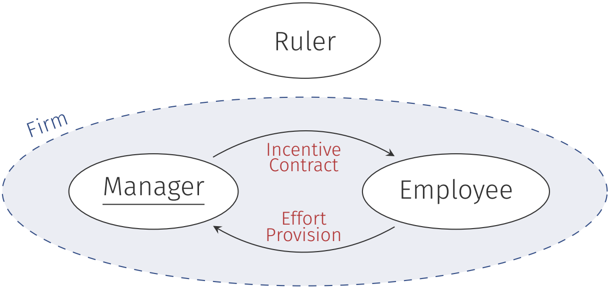

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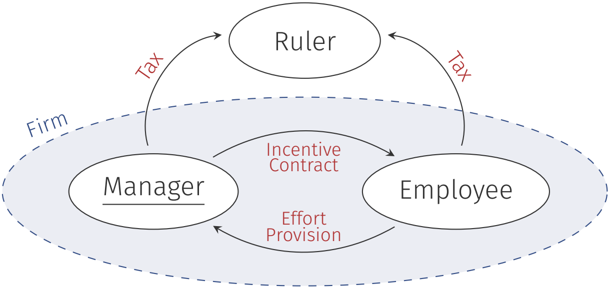
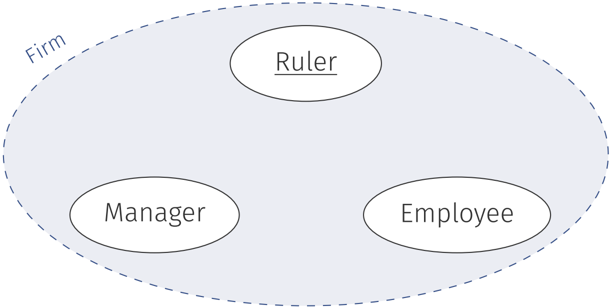


What is State Governance?

In a **state** firm, <u>Ruler</u> owns output and has contracting power



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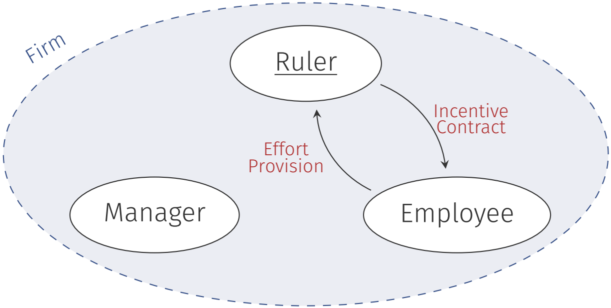

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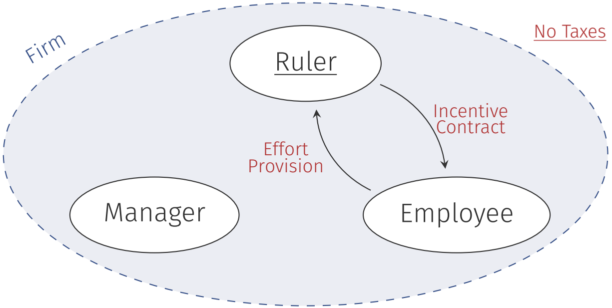

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Under **private** gov, Ruler can tax you more than promised

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 τ $\Rightarrow$ **Strong** institutions $\Rightarrow$ Low incentives to expropriate
- Low τ $\Rightarrow$ **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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If τ is low, **state** governance and flat incentives are optimal

Comments

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

what else can be done?

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> **Why?** An asymmetry in the timing of expropriation? (Comment 1)

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> **Why?** An assumption on random contractability of effort? (Comment 2)

Comment 1

Model has an asymmetry in the timing of expropriation:

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

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

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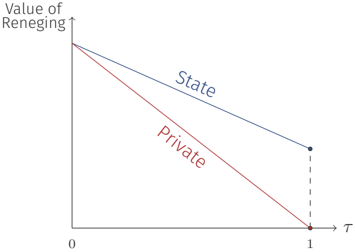

Reneging is less attractive under private gov, which thus has advantage at high-pwr contracts

Comment 1

The assumption is reasonable:

- It is easier to renege on a due payment than changing the tax rate!

Yet, it is a subtle detail rather than a fundamental force

Q. Can you do without?

Comment 2

Model assumes effort is **randomly** contractible

When effort is contractible, state gov can implement first best with flat-wage contract. Private gov cannot, due distortionary taxation

Thus, state gov has an advantage at fixed-wage contracts

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Somewhat nonstandard assumption: its impact on result is subtle

Q. Can you do without?

conclusion

Taking Stock

An ambitious and elegant research question

Main result is highly nontrivial, and with policy relevance

Overall, an excellent piece of applied theory

I wish the mechanism could be transparent: The value of a simple model thank you