Instructor: Levent Koçkesen, CASE 253, 338-1354, lkockesen@ku.edu.tr
Office Hours: TuTh 16:00 – 17:00

Time/Location: TuTh 10:00 – 11:15 / ENG B20A

Description: This course analyzes problems and issues created by informational asymmetries and how properly designed contracts could ameliorate those problems. Topics include adverse selection, screening, signaling, and moral hazard, as well as various applications to insurance, labor and credit markets, corporate finance, and organizational design.

Textbook and Lecture Notes: The course will be based on the lecture notes that will be posted on the course website:
http://home.ku.edu.tr/~lkockesen/teaching/contract/econ432.html

In addition, there are many undergraduate and graduate level textbooks that you may find useful:


Salanié’s book is available in the University Bookstore.

Prerequisites: ECON 201 and ECON 333

Economic theory of contracts analyzes optimal design of contracts and institutions in environments characterized by asymmetric information and conflict of interest. Its main mathematical tool is nonlinear optimization under constraints. I will briefly review the methods of constrained optimization, but you need to have a basic background in calculus and probability. Most importantly, you should be comfortable with analytical reasoning and mathematical notation to be able to follow the lectures and the readings.

Grading: Grading will be based on two exams, a term paper, and class participation with the following weights:

- Exam I 35%
- Exam II 35%
- Paper 20%
- Participation 10%

Exams will be in-class and closed book. Midterm Exam will cover approximately the first half, and the Final Exam the second half of the course. Class participation will be measured by attendance as well as short quizzes and questions in class. Term Paper could either be a report on a paper or an application of the material learned in class to a topic of your choice. The paper/topic you choose could be theoretical or empirical.

Attendance Policy: Attendance is compulsory. Students who are recorded as absent in 14 or more class meetings will receive an automatic F grade. This includes excused absences. For example, 4 excused absences and 10 unexcused absences count as 14 absences and lead to letter grade F. You will be recorded as absent if you are late by more than 10 minutes or leave early, use your phone, chat with your friends, do work for other classes, or engage in any kind of disruptive behavior. It is your responsibility to keep track of your attendance record.

Make-up Policy: For each regular exam, a make-up exam will be granted only once and only in case of properly documented emergencies, such as a medical report from the school medical center. Students who want to take a make-up exam need to inform me by email as early as possible but no later than the day after the regular exam. Make-up for the midterm exam will be given within a week after the exam date. Make-up for the final exam will be offered during the make-up period announced by the registrar’s office. There will be no make-up for the make-up.

Classroom Code of Conduct: Please follow the Koç University classroom code of conduct, as stated on http://vpaa.ku.edu.tr/academic/classroom-code-of-conduct
Please turn off laptops, tablets, and mobile phones; Do not arrive late or leave early without prior permission; Do not engage in side conversations or other disruptive behavior.

**Honor Code:** Honesty and trust are important to all of us as individuals. Students and faculty adhere to the principles of academic honesty at Koç University. Academic dishonesty includes:

*Cheating:* Cheating includes, but is not limited to, copying from a classmate or providing answers or information, either written or oral to others, in an examination or in the preparation of material subject to academic evaluation.

*Plagiarism:* Plagiarism is borrowing or using someone else’s writing or ideas without giving written acknowledgment to the author. This includes copying from a fellow student’s paper or from a text or internet site without properly citing the source.

*Multiple Submissions:* Multiple submission includes resubmission of the same work previously used in another course or project, without the permission of the instructor for both courses.

*Collusion and Impersonating:* Collusion is getting unauthorized help from another person such as having someone else write one’s assignment, or having someone else take an exam with false identification. Impersonating a student in an examination is also considered a grave act of dishonesty.

*Fabrication:* Fabrication includes, but is not limited to, falsification or invention of any information or citation in an academic exercise.

*Facilitating Academic Dishonesty:* Facilitating academic dishonesty includes, but is not limited to, knowingly helping another student commit an act of academic misconduct (e.g., cheating, fabrication, plagiarism, multiple submissions).

These are serious offenses resulting in an F grade and disciplinary action.
A Brief Outline and Main References:

1. Introduction

2. Screening: Basic Models

3. Screening: Applications
   - Regulation
   - Financial Contracts and Credit Rationing

4. Signaling and Informed Principal Problem

5. Moral Hazard and Applications

6. Adverse Selection and Insurance Markets
7. Extensions and Other Applications

(a) Organizational Design and Allocation of Authority

(b) Corporate Finance

(c) Incomplete Contracts and Hold-Up Problem

8. Empirical Evidence