

Topics in the Economics of Advertising and the Economics of Regulation

Project leader: Grigory Kosenok

Consultants: Tirtha Dhar (UBC) and Ariane Lambert-Mogiliansky (CERAS)

The current project spans on two large fields of economics. The students are supposed to choose a topic from any field. Below a brief introduction to fields and possible topics for master theses are provided.

1. The Economics of Advertising

Advertising plays an important role in economics. It affects on profit of any firm as well as on consumption decision and as a result on utility of any consumer. This is why this topic attracts a lot of attention of economists. The modeling of advertising includes two main elements: (1) specification of firms and their advertising possibilities and (2) specification of consumers' demand together with their reaction to advertising. The current project intends to contribute to understanding of the role of advertising in economics. The detailed description of the history of development of the economic analysis of advertising can be found in Bagwell (2001).

The methodology

Our approach mainly uses elements of the theory of one shot and repeated games in discrete and continuous time together with Nash Equilibrium concept. The solution of a typical model requires good understanding mathematical tools from optimal control theory. Numerical simulations might be necessary when analytical results are infeasible. Also an empirical work which is related with a study of advertising is welcomed.

Suggested list of Master Thesis topics

1. Interaction of consumer loyalty and advertising

It is well known that the degree of consumer loyalty to some firm plays a significant role for profits collection of the firm. Consumer loyalty might be affected by advertisement. This research addresses the issue of how consumer loyalty can be formed by ads.

2. Informative versus persuasive advertising: what is preferred most by a firm?

In this research an industry with many firms is considered. These firms are supposed to have heterogeneous characteristics. The purpose is to find what kinds of advertisement get chosen when these firms are involved into oligopolistic competition.

3. Prestige and advertising

It is known that prestige plays an important role in modern economics. This research suggests considering an industry where consumers have concern about not only product itself but rather the prestige this product brings to the consumer. In this model firms will compete by advertisement to build the prestige for their products.

4. Advertising and stability of a cartel

The issue of tacit collusion is well studied in IO. In this topic the issue of stability of collusion is considered when firms' strategies include advertising which, in turn, might be imperfectly observed by the members of the cartel.

Preliminary Readings

- Bagwell, K., "The Economics of Advertising, Introduction", mimeo, 2001
Butters, G., "Equilibrium Distribution of Sales and Advertising Prices", *The Review of Economic Studies*, 44, 1977, 465-491
Klein, B. and K. Leffler, "The Role of Market Forces in Assuring Contractual Performance", *Journal of Political Economy*, 89, 1981, 615-641
Grossman, G. and C. Shapiro, "Informative Advertising with Differentiated Products", *Review of Economic Studies*, 51, 1984, 63-82
Milgrom, P. and J. Roberts, "Price and Advertising Signals of Product Quality", *Journal of Political Economy*, 94, 1986, 796-821
Bagwell, K. and G. Ramey, "Coordination Economies, Advertising and Search Behavior in Retail Markets", *American Economic Review*, 84, 1994, 498-517

2. The Economics of Regulation

Monopoly power, externalities and incomplete markets are among the market failures that motivate government intervention in the economy. But government intervention is also plagued by inefficiencies. Some interpret government failures as evidence that politicians are intervening in the economy to further their career or wealth rather than to correct market imperfections. Others point to the agency problem characterizing government intervention. Government intervention requires the use of agents to collect information, make decision, and implement policies. As all economic agents government employees are self-interested. By virtue of their superior information, they are hard to monitor perfectly. Using tools from game theory including agency theory a significant literature has developed addressing inefficiency and corruption in government intervention. We propose two topics within this rapidly expanding field.

Suggested list of Master Thesis topics

1. Corruption in entry procedures:

The creation of new enterprises or the launching of new industrial projects is regulated in most countries. A main reason is to screen potentially harmful projects from socially beneficial ones by requesting conformity with a series of regulations. In many countries entry procedures are plagued by inefficiencies and corruption. The idea of this project is to work on a unique experimental study of corruption by Bertrand, Djankov, Hanna and Mullainathan from Harvard. The student should first try to relate the data to the theoretical literature and then develop a simple model to capture the role of intermediary agents.

2. A mechanism to combat favoritism in procurement

Procurement procedures are aimed at creating a competitive market for objects that cannot be purchased on regular markets. Corruption in procurement procedures is a widespread phenomenon. There exist several auction theoretical papers addressing aspects of corruption in first price auction. Other authors have investigated the issue of favoritism in multiple criteria auction. Favoritism is present when tender documents are biased in favor of some firm(s). There exists casual evidence that firms engaged in procurement tenders are quite well aware of which firm(s) is favored by tender documents. The idea with this project is to depart from a simplified version of Lambert-Mogiliansky and Kosenok model of favoritism and to investigate how one exploits firms' private information to combat favoritism. More precisely the student is expected to devise and investigate a simple mechanism of pre-auction consultation as a mean to reduce the costs of favoritism for society.

Preliminary Readings

- Susan Rose-Ackerman (2006) ed. "Handbooks Of Economics of Corruption"
- Laffont and Tirole (1993) "A theory of Incentives in Regulation and Procurement" MIT press
- Banerjee A. (1997) "A theory of Misgovernance" QJE Vol. 112, No. 4, Pages 1289-1332
- Shleifer and Vishny (1993) "Corruption" QJE 108/3 599-617
- Acemoglu and Verdier (1998), "Corruption, Property Rights and the Allocation of Talents: a general Equilibrium Approach" *Economic Journal* 108 1381-1403
- Burget and Che (2004) "Competitive Procurement with Corruption" RAND 35(1), 50-68
- Y-K Che (1993), "Design Competition Through Multidimensional Auctions" Rand Journal of Economics, Vol. 24/4 668-680
- Compte, Verdier and Lambert-Mogiliansky (2005) "Corruption and Competition in Procurement Auction" *RAND* 36/1, 1-15
- Ariane Lambert-Mogiliansky and Konstantin Sonin (2006) "Collusive Market-sharing in Public Markets" *JEMS* 15/4 2006 883-908
- Ariane Lambert-Mogiliansky and Grigory Kosenok (2007) "Public Market Tailored for the Cartel: Favoritism in repeated auctions" mimeo
- Tirole Jean (1986) "Hierarchies and Bureaucracies – On the role of collusion in organizations" *Journal of Law, Economics, & Organization*, Vol. 2, No. 2, pp. 181-214
- Kaufman D. and J. Hellman G. Jones (2000) "Seize the State, Seize the Day: and Empirical Analysis of State Capture in Transition Economies" Policy Research Working Paper 2440 World Bank Washington
- Bertrand, Djankov, Hanna, Mullainathan (2006) "Obtaining a driving license in India: An experimental approach to corruption." Mimeo Harvard
- Lambert Mogiliansky, Majumdar and Radner (2007) "A Strategic Analysis of Petty Corruption" *JDE* 83/2 351-367