



*Conferimento della laurea honoris causa al Professor Jean Tirole da parte  
dell'Università LUISS Guido Carli*

**Ministero dell'Economia e delle Finanze**

Laudatio del Ministro dell'Economia e delle Finanze  
**Prof. Pier Carlo Padoan**

*Roma, 19 marzo 2015*

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**Aula Magna Mario Arcelli – Luiss**

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It is hard to overestimate Professor Jean Tirole's contributions to Economics. The width and depth of his intellectual curiosity and scientific achievements will be long-lasting as well as his own way of tackling thorny technical issues and approaching policy-relevant problems: A scientific taste that is both essential and enlightening.

Academics and policy makers owe Professor Tirole a lot. And I cannot help but think of the amount of gratitude from students who have grown up with his book on Industrial Organization. How many of them have become familiar with the modern approach to topics such as horizontal and vertical practices, or markets for durable goods - to name just a few - since the book was published in 1988?

Today, I wish to focus on some contributions that would immediately speak to my personal and professional experience with specific emphasis on European issues, which absorb a significant amount of time and energy of EU finance ministers.

Where Professor Tirole most clearly expanded, and questioned to some extent, mainstream microeconomics is the theory of the firm conceived as a monolithic organization. While enlarging the Principal-Agent framework, his research has explored various forms of intra- as well as inter-

firm conflicts, shedding new light on corporate governance and the nature of the interaction between extrinsic and intrinsic incentives.

The Principal-Agent relationship is ubiquitous in human organizations. It characterizes, at least partially, the relation between a doctor and her patient, shareholders and managers, entrepreneurs and workers and, between a democratically elected Parliament and the Government.

Modern organizations are, however, too complex to be explored by observing them exclusively through the lens of the “traditional” Principal-Agent model. And to this effect Professor Tirole has enriched our comprehension of many private and public organizations in at least two different ways. First, his 1986 “Hierarchies and Bureaucracies” crucially deepened our understanding of organizations by having the Principal employ a supervisor to monitor the agent’s activities. As Professor Tirole wrote: “[...] *[O]rganizations can be seen as networks of overlapping or nested principal/agent relationships...This research [...] views an organization as network of contracts that interplay rather than a single contract.*” In such a three-layer structure the supervisor and the agent might be tempted to form a coalition to profit from their informational advantage. This might give rise to “*spaces for collusion between the supervisor and the agent*”.

It is all too easy to emphasize the empirical relevance of this stylized theoretical framework.. Official investigations have uncovered long-term collusive strategies involving the firm’s key decision-makers and auditors to misreport the firm’s real financial and economic conditions to financial markets. Public procurement markets are also in the limelight because of corrupt practices taking place between contract managers and contractors at the execution stage of civil works, including large infrastructural projects.

To write the optimal contract in three-layer organization, a “coalition-incentive compatibility constraint” has to be added, which induces the supervisor not to misrepresent her private information. Applying such a model to the study of corruption in contemporary politics where we

model representative democracy as a principal-agent relationship is particularly insightful. In his section *Who colludes with whom?* Professor Tirole states that “...*The reader might be misled by my emphasis on the supervisor-agent coalition and infer that (effective) coalition naturally arise between the lower tiers of a vertical structure...*” whereas “*a coalition can form between the judicial system and the police against the convict, and between the colonel and the captain against the conscript.*”

Another relevant feature of both public and private organizations is the allocation of decision authority. Delegating tasks to agents raises the initiative of agents, but at the cost of the principal losing control. Thus “formal” and “real” authority in organizations need not coincide. Concretely, having an entrepreneurial bureaucracy in a modern state may weaken the politicians’ “real” authority.

It is tempting to apply the three layer organization scheme to the European Union where a principal (the EU parliament) faces an agent (the Commission) and a supervisor (the Council). I would not go as far as describing European institutional dynamics as one in which the supervisor and the agent coalesce against the principal. Based on my experience, however, there is a need of a more balanced relationship among the three players, especially at a time when Europe is struggling to identify and implement a more effective long term economic strategy to deliver growth, jobs, and welfare. The recent decisions in terms of investment strategy and flexibility suggests that progress can be achieved. But, this is just a first step, political ambition must be stepped up. The principal must have a stronger voice and a more effective three players relationship must be put in place.

We have learnt a long ago that incentives matter. Professor Tirole has, however, taught us that they may work in a particularly subtle way. For instance, the “time” dimension of incentives plays a crucial role. Again taking the EU as an example we may appreciate the difference between ex ante efficiency, i.e providing the right incentives, and ex post efficiency, i.e rescuing failing institutions.

In the European case, most notably in Euro area governance, rules actually serve two purposes: contributing to the functioning of the economy, and supporting reputation building and mutual trust. I.e. reputation and trustworthiness are assessed by the amount of abidance to the rules. If, however, rules turn out to be inadequate to cope with exceptional circumstances (such as a prolonged recession) fully respecting ex ante efficiency may lead to self defeating behavior, and to a breakdown of institutions. A contradiction may arise between preserving the institution and preserving reputation. Two examples come to mind: a mechanistic implementation of the debt rule that would lead to self defeating debt dynamics; an assessment of a fiscal effort based on a flawed measure of output gaps which, again would be self defeating. Building confidence and mutual trust is essential for the strengthening of European institutions. So it is essential to have rules that insure a mutual consistency between ex ante and ex post efficiency.

Rule design should also reflect good understanding of incentives that actors face. In the European policy debate it is often stated that an expansionary policy stance weakens incentives to introduce badly needed structural reforms. This view can be challenged on a number of grounds. One is that structural reforms produce more benefits, and hence consensus for the reforms themselves, in an expansionary macroeconomic environment. Another is that governments often recognize that reforms are beneficial for their own sake and not because imposed from outside. In this case if incentives are not clearly understood, ex ante and ex post efficiency may clash, and lead to inferior outcomes, where neither macroeconomic policy support nor structural reforms are implemented. Hopefully this is not the case today, possibly suggesting that incentives in the European policy environment are becoming better aligned. Again this is not enough. Ensuring the right policy mix in a monetary union requires stronger institutions that guarantee that incentives are correctly identified and mutually consistent. The fragility which the financial crisis has unveiled is there to demonstrate this point. The response to the crisis has been and needs to continue being stronger institution building.

In conclusion Tirole's achievements lead to sounder microfoundations of macroeconomics. These achievements offer a more problematic view of markets and organizations than the neo walrasian general equilibrium approach and recognize the possibility of market failures. In their turn, market failures open the door for public interventions and for unconventional policy tools as well as for sound institution building. I do not have to reiterate how such aspect is crucial in the current phase of European history.

Professor Tirole has contributed and keeps contributing to our better understanding of the working of markets, intermediaries, and government interventions as complex institutions. These are fundamental steps not only to produce more advanced microeconomic and macroeconomic analyses but also to elaborate and implement more robust and effective policy tools and institutions. For a policy maker founding policy decisions on a rigorous analytical approach may look as adding one (maybe unnecessary) layer of complexity; I would not share this view. Decisions taken on that basis prove to be ultimately more effective than otherwise. In conclusion Tirole's outstanding contribution has, indirectly, made the job of a Minister a bit more difficult. However, to the extent this allows to achieve positive, more effective, and more robust results this would be also due to Tirole's economic insights and break through contributions .

Thank you.