PROPOSAL: RENT EXTRACTION IN THE FINANCE SECTOR – RETHINKING THE FIRM AS A SET OF CONTRACTS AND THE PRODUCTIVITY GAINS FROM INCREASING CAPITAL TO LABOR RATIOS

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Summary:

The question of what proportion of the financial market activity is about value creation as opposed to vale extraction is at the very heart of much policy and popular press discussion on post global financial crisis (GFC) fixes to our financial sector. In order to posit sensible policy responses however we need to start by getting a handle on the nature, reasons and extent of value extraction in the sector. We propose to return to some of the fundamental work on the theory of the firm as a set of contracts and ask the question what surplus can be extracted by the different factors of production that coalesce in the boundary of the firm through their contractual arrangements in the case of investment houses. So, the myriad claims on the value of the firm that are to be considered are those of the equity holders, the human capital and the factors of production (it is worth noting that for financial institutions, creditors and the public sector as holder of the contingent risk are important stakeholders). The conjecture that the remuneration of financial market executives is a failure of the governance architecture that enables rent extraction at the level of the firm then flows onto a broader question of value extraction by the industry. A related, but slightly different observation is about the productivity gains that accrue from increasing capital to labour (human capital?) ratios. What does such productivity enhancement mean in the financial sector? If not productivity, then what does increasing sophistication in technology render to the financial sector, and those that are best placed to define the rent division in an incomplete contracting world?

Tasks:

- Relevant review of extant literature (may be related to work on human capital and optimal boundaries of the firm)

Skills: Economics major