

Tijdschrift voor Economie en Management
Vol. L, 5, 2005

Laudatio for Professor David P. Baron

by R. DE BONDT



Raymond De Bondt
KULeuven, MSI : Bedrijfseconomie, Strategie
en Innovatie, Leuven.

In most universities it is as if professors work with what economists call diseconomies of scope. They are not broadly diversified in their knowledge and output, in most cases they have a rather limited scope, they are specialized. In fact it is not unusual to observe that the higher the ranking of the professor (according to usual measurable standards), the more specialized she or he is. And so the top, the star scientist, is a little bit like the famous racing cyclist who won the Tour de France 7 times (so far?).

Most people would agree, at least in Belgium, with a slight chauvinistic inspiration, that true greatness is found only in a champion like, you know who, a champion who not only repeatedly wins specific important contests, like the Tour de France, but also world championships and classic (sort of grand slam) races. Such a star is simply more complete in his excellence.

The races in science in many cases are so different and demanding that specialization makes perfect sense and, like in Adam Smith's pin factory, increase overall productivity. But many problems and phenomena studied in economics, management, sociology, political science, parts of psychology and philosophy are in fact, if not identical, very similar. All of these disciplines study, for example, rivalry and cooperation in non market environments. Therefore steps towards unification of analysis very probably are worthwhile. But with specialization of scientists it is hard to do. So we need more complete top scientists, with a broad scope of talents and expertise. Professor David Baron is such a scientist.

Dave Baron is a chaired Professor of Political Economy and Strategy (David S. and Ann M. Barlow endowed chair) at the Graduate School of Business, Stanford University. He moved to Stanford in 1981 from the Kellogg School of Management at Northwestern University, after obtaining in 1968 a Doctor of Business Administration from Indiana University and an MBA from Harvard University in 1964.

He has been a visiting professor at Harvard, Princeton, Université D'Aix-Marseille, and the Catholic University of Leuven. Baron has delivered distinguished lectures at Harvard, Indiana and Northwestern University. At the Kellogg School of Management of Northwestern, he was a teacher of the year, and chairman of and professor at the department of Managerial Economics and Decision Sciences; there he was a key player in building that department into a world class place for research and teaching in managerial economics and game theory. Shortly after his arrival in Stanford he founded a whole new field and approach to political economics for business, he later was voted best teacher of the year in the Ph.D. program, served as the associate dean of academic affairs, and last year received the prestigious Robert T. Davis award for lifetime service.

Baron is or has been on the editorial boards of the "American Economic Review", the "Quarterly Journal of Economics" and the "Journal of Economics and Management Strategy", he is a Fellow of the Econometric Society, the author of several books including the fifth edition of his best selling textbook on "Business and its Environment", he has about 50 articles published in first rate, high impact journals (what we call here A journals) in management, statistics, finance, political science, general economics, public economics, industrial economics, and information economics. A number of his publications are extensively cited.

By the end of the 1970's economists had no doubt that regulation of competitive industries and public utilities lacked in many cases effectiveness and efficiency. This led them to recommend privatization, liberalization, deregulation and improvements in regulation. A worldwide trend was the surge of so called incentive regulation. It means that the regulator delegates certain pricing decisions to the firm and that the firm can reap profit increases from cost reductions. It also means the regulator recognizes the firm's information advantage. The corresponding ideas and the search for incentive mechanisms received in 1982 a substantial and innovative burst from the contribution of Dave Baron (with Roger Myerson) in an *Econometrica* article "Regulating a Monopolist with Unknown Costs". The price regulation is modeled as a Bayesian game in which the regulator chooses a mechanism that is optimal given the optimal response of the firm, and given that mechanism the firm chooses an optimal strategy conditional on its private information. By the revelation principle, the regulator can restrict attention to the class of incentive compatible mechanisms, such that the firm has no incentive to misrepresent its type. A rich literature on incentive regulation developed with Dave Baron, French, UK and other economists contributing. New regulatory practices such as price cap regulation, while not Bayesian, at least do away with regulation mechanisms relying on observable characteristics.

All of this came after Baron's research on the effects of traditional regulation based on characteristics such as rate of return on invested capital that he started during his Leuven visit in the academic year 1977-1978. It was also in that period that the analysis of asymmetric information in decision theoretic and game theoretic settings began to flourish. And as is so typical of

Dave Baron, he not only saw quickly the potential of these new methods, but was even faster in using them creatively in his innovative research. He presented early contributions on asymmetric information theories in a doctoral course here in Leuven, well before this material became standard all over the world.

Regulation is only a small part of the relations that exist between firms and their non market environment. In the beginning of the eighties we saw the birth of new analytics of market strategies (competitive, corporate) at the east coast of the United States (with Michael Porter) and almost simultaneously, but at the west coast in Stanford, Dave Baron began to develop the new analytics of non market strategies. In the market environment firms interact with consumers, employees, suppliers, and capital through voluntary exchange underpinned by a system of property rights. The non market environment is composed of the social, political and legal structures in whose context firms interact with stakeholders, governments and the public. As Europeans we should welcome the development of this new field on the management of the non market environment. The current European culture after all, in many instances, tends to give a lot of weight to non market aspects in the political and institutional environment. While market transactions of goods and money are very important, they are but a small part of what people's activities involve in almost all organizations and society at large. Many top business schools in the US have imitated his move and since 1995 we have also in Leuven courses on "Political Business Strategy" and on "Politics and Business" taught by one of Baron's former Ph.D. Students, professor Christophe Crombez.

Why did Dave Baron, and not someone else, start this new field? Being incredibly fast in seeing and using the potential of new technologies for research, helps, of course. But in addition, he showed the energy and talent to learn the details, with openness and honesty, of the relevant institutional and real world aspects, and the related contributions made by other disciplines. Most of his theory papers go far beyond referring to a few stylized facts.

A good first example of this is perhaps his influential work (with John Ferejohn) on "Bargaining in Legislatures" published in 1989 in the American Political Science Review. In one of the most important accomplishments in social sciences, Nobel laureate Kenneth Arrow demonstrated in 1963 that it is generally impossible to design institutions that aggregate the diverse preferences of individuals to make a social choice in a manner consistent with a set of reasonable conditions. It was shown in 1976 that when voting reflects people's preferences over multiple characteristics, typically chaos will result in the sense that, anything can happen and whoever controls the order of voting can determine the final outcome.

Presenting such findings to young people carries the danger of them prematurely developing a cynical attitude. But in fact political decision making works differently from a setting just mentioned wherein all alternatives are compared to all other alternatives. Lawmakers for example work within given structures (parliamentary committees) and bargain within

rules for agenda formation and voting. Dave Baron was the first to develop and analyze a game theoretic framework capturing these elements. He was able to characterize what voting procedures are necessary and sufficient for self enforcing strategies (on what motions to make and how to vote), and to analyze for example, the choice of amendment rules. When no party has a majority of seats, the analysis predicts that the smallest part is most likely to be in the government. So he replaced chaos with a positive theory of how people organize for political decision making.

Another more recent example is his 1997 work in which he integrates the market and non market strategies of Kodak and Fuji film in a formal theory of the resolution of trade disputes and the subsequent effects on market competition. The background is the 1995 Eastman Kodak complaint on alleged unfair Japanese distribution practices. His framework employs a Bertrand Nash game in prices and a super game equilibrium to model sustainable Japanese concessions on opening distribution systems. The consequences of trade negotiations between governments are captured by a Nash bargaining solution, the parameters of which the firms can influence through their non market strategies. This way he is able to grasp this very complicated web of interactions, and to better understand the synergies between market and non market strategies of global competitors.

And thus today the field of political strategy is flourishing. We see researchers in business schools clarifying phenomena far from the market such as the pros and cons of the jury voting procedures in murder trials. Dave Baron, in recent work, presents asymmetric information games to endogenize information provision. This work explains, for example, the emergence of informational alliances with no hierarchy; say between suppliers of automobile parts, that Pareto dominate mergers, independent contracting and hierarchical contracting. But it also tackles informational competition between interest groups trying to influence public sentiment, with media, because of their role in society, having an incentive to bias reporting in favor of regulation.

Professor Dave Baron is a unique scholar in economics and management science, because of the depth and creativity of his research and teaching, but also because of the broad scope of his work, covering not only several existing subfields, but also inventing new crossings to other disciplines. He made lasting contributions to the unification of social sciences. His career is an example for all times and we in Leuven have been lucky and are grateful to have benefited from his expertise, support and leadership.

Om al deze redenen, mijnheer de rector, verzoek ik U, op voordracht van de Faculteit Economische en Toegepaste Economische Wetenschappen en na goedkeuring door de Academische Raad, het eredoctoraat van de Katholieke Universiteit Leuven te willen verlenen aan professor David Baron.

Leuven, 8 november 2005