

INSTITUTIONAL ECONOMICS

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Course Material Developed by Department of Economics,
Faculty of Social Sciences, Eötvös Loránd University Budapest (ELTE)

Department of Economics, Eötvös Loránd University Budapest

Institute of Economics, Hungarian Academy of Sciences

Balassi Kiadó, Budapest



Author: János Mátyás Kovács
Supervised by János Mátyás Kovács

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Week 9

New Institutional Economics II New Economic History. New Comparative Economic History and Economics

Contents

- History and economics
- North
- New comparative economic history
- New comparative economics

History and economics

- History and culture are favorite explanatory principles in OIE (evolution); identity marker to fight neoclassical theory
- Thus, NIE's most spectacular border crossing is the combination of history with

modern economics (assuming rationality retroactively, formal models, etc); imperial invasion? (Nobel Prize)

- Key theme: emergence and change of institutions; historical analysis with economic instruments or just the opposite?
- Why do institutions exist? (Coase); how do they emerge? (new economic historians)
- What is less important for us here: measurement (cliometrics and counter-factual analysis); Fogel: slavery, railways; North also starts off by estimating the overall transaction costs in the American economy
- Quantification and formalization: game theory and institutional econometrics: modelling a problem instead of interpreting a case
- Simultaneously, economic history intermingles with political, legal, cultural etc history
- Surprising/counter-intuitive results

North

- North's leading role: founding the school; in cooperation with the Coase-Williamson research program (mutual justification); moving away from a firm-centered inquiry
- From American economic history, through the explanation of the rise of the Western world (Weberian question), to general economic history; abandoning cliometrics
- Key analytic dimension: institutional change, formal and informal
- By 1990, emphasizing the cultural specifics of historical change; co-evolution of institutions and ideologies; commonly shared mental models (Veblen: "shared habits of thought")

– *Institutions, Institutional Change and Economic Performance*, 1990

– *Understanding the Process of Economic Change*, 2005

- Subtitle of his *"Rise of the Western World"*: new economic history (other names: historical economics, econometric history, political economy of the past)
- Econometrics is not enough, theory is needed: "... *If we have found slavery profitable, railroads less than essential, and the net burden of the Navigation Acts 'light', we have not said what did make the system go.*" (1974) – turning to transaction cost economics
- Defining the notion of institution (folklore version: rules of the game) : "*Institutions are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self imposed codes of conduct), and their enforcement characteristics*". (1994)
- North's evolution: a Marxist first; turning to neoclassical theory; partial disappointment; writing economic history with the help of concepts such as rational choice, price theory, institutions as efficient solutions; returning to a theory of institutions, which is based on rules of the games determined by the powerful players (public choice influence)
- In the short run: allocative efficiency; in the long run: adaptive efficiency (evolutionary idea)
- Institutions and organizations (rules of the game versus the players): "*The organizations that come into existence will reflect the opportunities provided by the institutional matrix. That is, if the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities then organizations – firms – will come into existence to engage in productive activities.*" (1994)
- Why do institutions change? Change of prices and preferences, the organizations force them to change, mentalities (beliefs, ideologies) change; the changes are gradual, especially with the informal institutions ("fast- and slow-moving"

institutions)

- Importing institutions: frequent changes during the process of importation, and the performance diminishes
- Institutional learning, institutional complementarity
- Inertia of institutions, path dependence, lock-in; cumulative/ lasting development is not typical
- Relationship between the "institutional matrix" (economic, legal, political as well as formal and informal features) and economic performance: this is the core of North's research program.
- Main issue: identifying the incentives (by means of property rights analysis)
- Historical case studies; North, Weingast, Greif and their followers: 17th century England, medieval trade, industrial revolution, North- versus South-America, guilds, etc
- Exogenous/endogenous institutions: a compromise
- Trust, authority, social capital, etc: including more and more cognitive elements in the analysis

New comparative economic history

- Rapidly expanding subdiscipline, still without a proper name; Greif: historical-comparative analysis
- Authors: Acemoglu, Aoki, Greif, Robinson, Johnson, Aghion, Roland, Glaeser, Shleifer, Vishny, Djankov
- A major interest in economic development, and sensitivity toward political, legal, cultural matters (Gaidar in 1991: "*Henceforth books on comparative economic systems will be found on the shelves dealing with economic development.*")
- Greif continues the Northian research program: spontaneous emergence of

institutions; using game theory; cultural effects: comparing trade networks in Genova and North-Africa; emphasis on beliefs and norms

- Case studies: police, credit card companies, slavery, Jewish traders in New York, etc
- Aoki: developing the analytical instruments; institutions as states of equilibrium
- Institutions lend themselves to game theory: rules, contracts, cooperation, coordination, agency, informality, etc
- Aoki, 2001: *"An institution is a self-sustaining system of shared beliefs about how the game is played. Its substance is a compressed representation of the salient, invariant features of an equilibrium path, perceived by almost all the agents in the domain as relevant to their own strategic choices. As such it governs the strategic interactions of agents in a self-enforcing manner and in turn is reproduced by their actual choices in a continually changing environment."*
- Types of institutions: American, German, Japanese, Silicon Valley, global, etc – similarity to the *Varieties of Capitalism* paradigm in studying institutional complementarity
- Besides historical case studies, there emerges a need for ambitious model-building (econometric tools) in close cooperation with New Political Economy: Acemoglu as an example
- Cases replaced by problems? Level of analysis: countries rather than firms or industries; far from "thick description"; "very long term", "very broad comparison": a great number of thought experiments
- The "good" institution: protecting private property and providing wide access to the resources.
- Historical explanations based on conflicts of interest: economism?
- Main questions: transplantability of institutions, can they be designed?, which property rights are to be protected?, the economic disadvantages of democracy, political consequences of economic inequality; provocative (illiberal?) conclusions

- Examples: American colonies, Transatlantic trade, voting rights, democracy and dictatorship, French revolution, military regimes, etc
- Grand political concepts (revolution, coup, transition, oligarchy, populism, etc) explained by economic means: strong proofs? predictive force?
- Pros and cons of decontextualization
- *Journal of Comparative Economics*, methodological switch; manifesto: Simeon Djankov, Edward Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, *The New Comparative Economics*, 2003 (Boettke calls the new subdiscipline comparative political economy)
- In contrast to Comparative Economic Systems, communism is disregarded; post-communism is however part of the research program (Eastern Europeans among the authors); methodology comes from new comparative economic history (authors overlap), in which East-West comparisons are not central
- Institutions and their impact on economic performance; neoclassical approach (is less more? – Brada)
- Key concepts: "institutional possibilities frontier" and "civic capital"; between the two extremes of chaos and dictatorship; chaos is characterized by private predation, dictatorship by state predation (market versus command economy?); civic capital is more than social capital (culture, ethnicity, geography, etc are also implied)
- Social costs (not the transaction costs) are to be minimized; both chaos and dictatorship are dangerous but there is a trade-off; dictatorship may be a cheaper means to eliminate chaos
- Synthetic, unmeasurable variables?

Readings

Mandatory

Greif: Historical and Comparative Institutional Analysis, 1998

North: Institutions, Institutional Change and Economic Performance, 1990 (chapters)

Djankov et al: The New Comparative Economics, 2003

Acemoglu: Why Not a Political Coase Theorem?, 2003

Additional

Diamond: Guns, Germs and Steel, 1997 (chapters)

Aoki: Toward a Comparative Institutional Analysis, 2001 (chapters)

North and Weingast: Constitutions and Commitment, 1989

Fogel: Time on the Cross, 1974 (chapters)

Annex

Biographical sketches

– North

– Fogel

Final questions

– Predecessors/successors of the school

– Friends and foes

– Discoveries

– Changes in the research program