

Summary

-Institutional Economics-



Table of Contents

Lecture 1	3
Lecture 2	4
Lecture 3	6
Lecture 4	8
Lecture 5	11
Lecture 6	13
Lecture 7	14
Lecture 8	16
Lecture 9	17
Lecture 10	19
Lecture 12: application case 2	23
Quizzes	24
Exam:	27

Lecture 1

Why institutional Economics (IE)?

- To complement neoclassical economics and reduce failures of neoclassical economics
- How people/actors behave in standard model → utility maximization under constraints (self-interest)
- Three components:
 1. Preferences & utility function (U)
 2. Constraints (budget) (C)
 3. (relative) prices (P)
- Behavior $B = \text{Max}_{U,C,P}$
- Institutional economics adds realism: IE can explain absence of real-world phenomena

Neoclassical economics (NE)

- Actors are hyper-rational
- Markets always exist & never fail (pareto optimal)
- Prices reflect only relevant information
 - Identity of buyer/seller immaterial
 - No transaction costs
- The base is the individual trying to maximize their utility under certain constraints.
- Every point of friction/tension will be totally worked out in the market in the most efficient way.

In reality it is much more complex.

IE adds realism: IE can explain absence of real-world phenomena.

Difference NE and IE:

In NE they consider institutions as exogenous, as taken, important to consider markets are efficient.

In IE we consider that the forms of economic/societal organization are considerably different depending on the environment.

IE

Economic actors are embedded in particular institutional environments

What do institutions do? Govern (economic) exchange

It is about social relationships between individuals who have different preferences and values. Social context is important.

Standard macro: investments → capital and knowledge accumulation → productivity → growth and development

What are institutions?

- Are systems of man-made rules that structure behavior and social interaction: All banks, governments, firms, university and rules/laws
 1. 'Rules of the game' (Douglass North)
 2. Social structures enabling meaningful social interaction
 - Notably economic exchange
 - Reduce so-called transaction costs (TCs)
 3. Act as incentive structure of a society
 - What type of behaviour is 'profitable'?

Formal institutions: public rules of behaviour that are

designed by a public authority with legislative power and

enforced by a public authority with executive power and a

judiciary power that has the right and power to penalize an

individual or organization for breaking the rule.

Informal institutions: private rules of behaviour that have

been developed gradually and spontaneously and do not

need legal enforcement.

Lecture 2

Old/Original Institutional Economics (OIE) (evolutionary approach/evolutionary institutionalism)

- Appeared first as a reaction to NE.
- OIE developed quickly in the beginning of the 20th century.
- Criticism on NE is that the way they look at the economy is too static.
- OIE considered the economy as dynamic. *We need to understand the historical evolution of institutions and systems of economic exchange*
- Central goal, to understand the transforming actions of institutions and market mechanisms over time.
- Institutions result from human action and will in return influence human action: dual direction. *We influence institutions and institutions influences us*
- *Imperfections are part of free markets and that's why we need institutions*
- *We need more empirical studies to understand complex realities.*
- *Substantive view of the economy= an instituted process of interaction between human beings and their natural and social environment > why do we organize he economy a certain way?*
- *Markets come from an institutional process and are a result.*

New Institutional Economics (NIE)

- Is like a mix between NE and OIE.
- That is why North approaches institutions as the rules of the game.
- NIE is about the formal definition of economics.
- Game theory is very important. The center of this discipline.

4 other **forms of exchange** and production outside of markets:

- **Reciprocity:** Exchange between social entities. Exchange is not done for profit but for social relationships between individuals. Mutual benefit.
- **Redistribution:** Central authority. A group of people producing for an entity which will redistribute according to its members.
- **Exchange:** Individual gain, *about institutions and quit recent (19th century)*

	Reciprocity	Redistribution	Exchange	Householding
Locus	community	central authority	instituted market	closed group
Dynamic	symmetrical	centric	multidirectional	introspective
Motive	mutual sociality	dues/obligations	individual gain	self-provision
Governance	societal	custom or law	price	circulation
Subjectivity	give-and-take	allegiance	bargaining	group
Object	gift	tax-tribute	commodity	own-use resources
Loci classici	Trobriand kula rings	Babylonian storage systems	19th-century capitalisms	rural economies; patriarchal family

- **Householding:** Family. For own use and consumption.

Market is a fundamental institution for the capitalist system to function.

Douglas North: "institutions as the rules of the game"

Game theory: Interdependent decision making.

Prisoner's dilemma

Pareto-optimal equilibrium= no individual can be better off without making at least one individual worse off.

Nash-equilibrium= optimal outcome after considering an opponents choice

- We are not isolated individuals, we act according to others decisions
- Multiplicity of equilibria
- Find a balance between cooperation and competition
- Rules stated for the game influence behaviors => institutions are central
- Different types of games, of players, of rounds to arrive to equilibria
- May also explain how institutions are created, equilibria can make institutions evolve or emerge (influence) > Douglas North

The game theory shows that it is not as simple as NE says. You need to take into account what other

people do. Also shows that you will not naturally have a pareto optimal outcome.

Shows that if you only act in your own self-interest you will not have the optimal outcome.

Level 1: *Embeddedness: informal institution, customs, traditions, norms religion.* Institutions are difficult to change. Related to OIE. Informal institutions. *Social theory*

Level 2: *Institutional environment, formal rules of the game.* Importance of formal organizations. Reducing uncertainty by correctly distributing property rights. Changing a bit faster. *NIE economics of property rights*

Level 3: *Play of the game.* Level of governance. More frequent changes.

Goal is to try to make every contract be fulfilled. Define the rules of the game. Goal is to reduce transactions costs. *NIE transaction cost economics*

Level 4: *Resource allocation and employment.* Related to NE. in relation to direct market mechanisms. Align different interests. Continuously changing. *Neoclassical economics/agency theory*

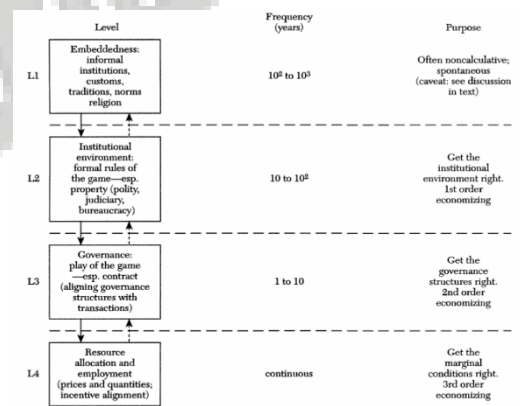
Not mention during the lecture but was in the summary last year

Capitalism and markets are historically constructed with the following characteristics:

- Means of production are privately owned.
- Production for the market.
- Profit oriented.
- Profit motive, inheritance law, supported by contract law, form the driving force of capitalism.

We need state intervention to turn this market process towards the public purpose because markets were focused on self-interest.

This dynamic approach resulted in two perspectives of economics.



L1: social theory
L2: economics of property rights/positive political theory
L3: transaction cost economics
L4: neoclassical economics/agency theory
Figure 1. Economics of Institutions

- Formal view: Economics is the logic of rational action and decision-making, as rational choice between the alternative uses of limited (scarce) resources.
- Substantive view (Polanyi): An instituted process of interaction between man and its natural and social environment.

- Focus on level 1
- Focus on the construction of diverse institutions, including markets
- Why do we have different institutions?
- Pluralism and methods from other discipline: historical studies, qualitative research, etc.

Shows the complementarity between the different theories.

Goal NIE: Trying to understand how we can make markets more efficient in terms of total welfare/outcome. → Transactions

OIE/evolutionary institutionalism

- Substantive definition

NIE

- Formal definition
- Focus on levels 2 and 3
- Focus on transaction costs, property rights, agency
- How to make markets more efficient and avoid opportunism?
- Pluralism and economic methods: game theory and statistical regression

Lecture 3

Types of goods

Private goods > High rivalry and high excludable

Food, clothing, car, house

Common goods > High rivalry and low excludability

Water, nature, environment

Club goods > low rivalry and high excludability

Swimming pools, telephone network, cinemas, unions, (needs a subscription)

Collective goods > low rivalry and low excludability

Defense, dykes, legal protection, sunshine, search engine

High rivalry= not available for someone else after you purchased it

High excludable= easy to exclude someone from buying the product

These different types of goods will bring different types

of **costs in exchange**:

- Transaction costs.

- Organizational costs.
- Social costs.
- Externalities
- Cost of risk.
- Cost of trust.

Externalities

When an activity positively or negatively impacts another party that is not involved in this activity.

- Negative externality: social costs > private costs or private benefits > social benefits. *Price is too low to reflect social costs (pollution of smoking)*
- Positive externality: social benefits > private benefits or social costs < private costs. *(bee keepers)*

Private costs = costs borne by initiator of some activity

Social costs = total costs borne by all members of society

Free riding

- Is a negative externality/ form of opportunism/ market failure.
- When people take advantage of being able to use a common resource, or collective good, without paying for it.

“Tragedy of the commons”(Hardin, 1968) = lack of clearly defined property rights (can) lead(s) to inefficient allocation of resources, *like fishing in different place as fishes are in everywhere in water, but are not unlimited available.*

Transaction Costs Theory (TCT)

“Costs of using the price mechanism” (Coase, 1937)

“Costs of running the economic system” (Arrow, 1969)

1. Search and information costs *identifying different trading opportunities, outlets and exchange partners*
2. Bargaining costs *negotiating acceptable trading agreements*
3. Policing and enforcement costs *monitoring trade conditions and enforce contractual terms*

Transaction characteristics

1. Uncertainty: Generic uncertainty as well as bounded rationality and opportunism (behavioral uncertainty).
2. Frequency: More uncertainty in smaller markets, because fewer transactions vs. larger markets, more transactions, less uncertainty. > repeated transactions justify the costs

3. Asset specificity: Exchange often involves investment in unique assets / resources that are nonmarketable / non-re-deployable. >

Due to this: incomplete contracts and hold-up problems.

Incomplete contracts

- Costs to think through all possible states of the world.
- Costs to write down all possible contingencies.
- Difficulty to describe a contingency unambiguously so that it can be verified by the court even if the contingency is obvious to the contracting parties.

Types of asset specificity

- Site specificity: e.g., coal mine.
- Physical asset specificity: e.g., investment in specialized equipment.
- Human asset specificity: e.g., firm-specific knowledge.
- Dedicated capacity: Designed for specific consumer.
- Brand name capital: Maintain reputation.

External and internal transaction costs:

External is between company

Internal is within a company

Law, economics, and ethics (John Commons)

Three types of transactions:

- Bargaining: Market transactions, transactions between buyer and seller.
- Managerial: About employment and management in any organization.
- Rationing (political): Any decision maker deciding how the wealth of a country is redistributed over the country.

Lecture 4

Why do firms exist?

Coase (NIE) → Firms are a response to Transaction costs.

- Exchange is organized so as to minimize the sum of production costs + transaction costs.

Ways of reducing transaction costs:

- Vertical integration: “An arrangement in which the supply chain of a company is owned by that company.”
- Internalization: “execution of transactions within the organization rather than relying on an outside market” → make by yourself instead of buy in the market.

Coase mentions this is not infinitely possible because at some point the costs of directing one resource internally is equal to the costs of just relying on markets.

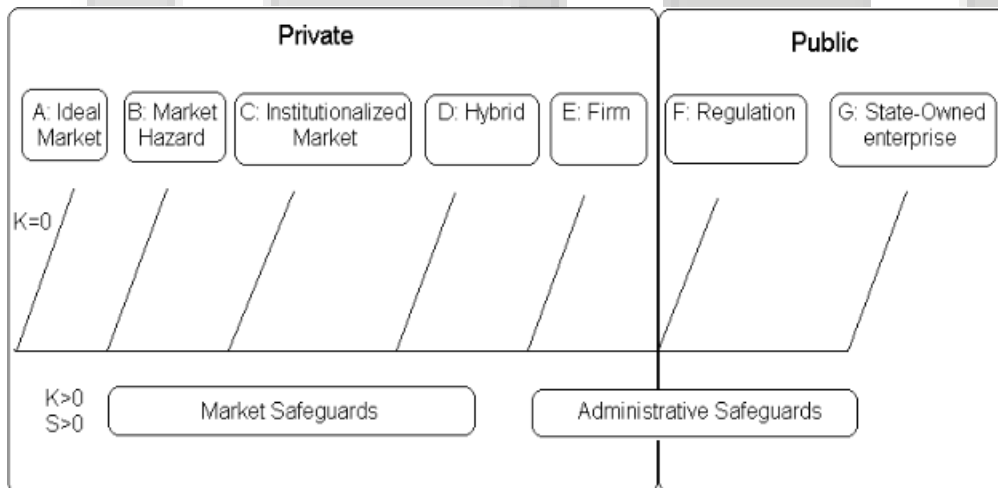
Firm size and transaction costs

-When the external transaction costs are higher than the internal transaction costs, the company will grow

=When the external transaction costs are lower than the internal transaction costs the company will be downsized (outsourcing)

Organizing/governing transactions

Markets → firms → public/government



K = level of asset specificity
S = level of safeguards

Node A: Low transaction costs, low uncertainty.

Increases in asset specificity and uncertainty will make you move along the scale. → You will need more safeguards.

More complex assets and markets means more complex means of internalization.

Market: A, B, C; Intermediate Hybrid: D; Hierarchy: E.

Transaction Cost Theory explains the transition from markets to hierarchies, and is market by the process seen above.

Market regulations: market governance involves transactions that are relatively simple, information on product specifications is easily transmitted, and producers can make products with minimal input from buyers (low external transaction costs) > supermarket or some clothing stores

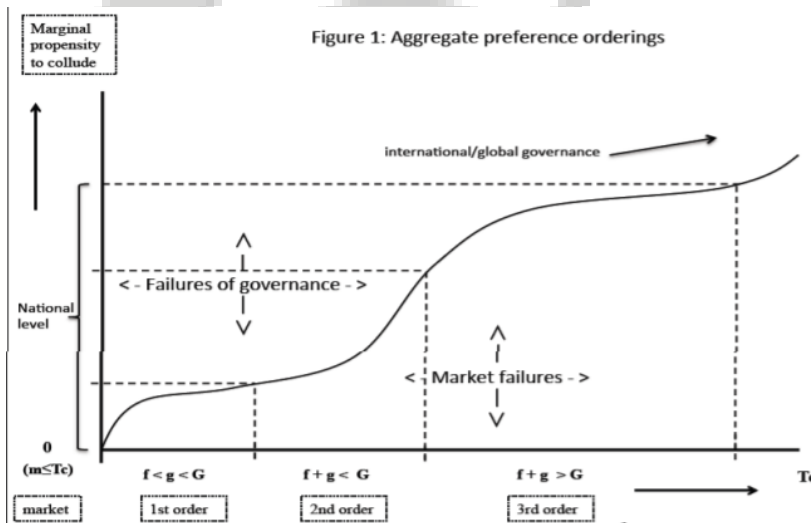
Vertical integration: if it is more advantageous to produce by yourself, internal transaction costs lower than external transaction costs > Netflix or Samsung

Solution? By merging the two companies (Ns and Prorail), the interdependencies will be placed within a single hierarchy. As a result, there is no incentive for opportunistic behavior and transaction costs decrease.

Hybrid governance (ally): located between market and hierarchy with respect to incentives, adaptability, and bureaucratic costs > joint ventures, partnerships, franchises

Underhill. An economic way to show the decision to internalize. It is beneficial for companies to coordinate themselves to reducing transaction costs and the marginal propensity to collude.

3 different orders of governance:



Market: market regulation, market governance.

1st order: Firm governance. Internalization.

2nd order: Private authority with more rules of the game and some agreed enforcement. Firms managing TC together. Association between industries.

3rd order: Need for 3rd party enforcement. Governments need to intervene. High level coordination.

f: aggregate preference for governance by firms. Firm, vertical integration, internalizing.

g: preference for industry standards/second order institutions.

G: preference for 3rd party enforcement/government.

Lecture 5

Property rights

A bundle of rights:

- Rights to use good.
- Rights to manage good/earn income from good.
- Right to transfer good to others.

All three → Owner/holder

Owner is the only one who can transfer a good to someone else

Owner = the one who is ready to pay the highest price for the good

Residual rights of control

Property rights determine who has the power to control a good within an institutional arrangement and consequently who has the right over the residual income.

Residual rights owner will always be the one who can dispose of the good. You can let someone else use the good or exclude people from using the good but you are still the owner.

Between rights and duties

The owner of a good can be held responsible. This causes the user to have less incentive to take care of the good.

Different forms of ownership

- Free use/access: clear property rights do not exist.
- Private property: individual or organization has rights to use, earn income and transfer.
- State or government property: state or government has right to use, earn income and transfer.
- Common property: group composed of individuals has right to use, earn income and transfer.

Why public ownership is desirable with prisons under incomplete contracts. Hart et al.

- Under privatization, the provider has the control rights and will implement cost innovation even if it damages the quality of the service.
- Under public ownership, the provider needs government approval for any innovations, and therefore a quality-damaging innovation would not go ahead.

Privatization is therefore not desirable for services where cost reduction can damage quality.

Public or Private

Decision will be a balance of considerations between cost-cutting/quality/possibilities to innovate/effect of competition

The case for public ownership is stronger when: non-contractible cost reductions have larger deleterious effects on quality: innovations are unimportant (no need for competition)

The case for privatization is stronger when: quality reducing cost reductions can be controlled through contract: incentives for innovations are important (competition can improve this)

Why do we need property rights?

- We need property rights to manage conflicts.
 - Can you plant a tree on your property if it shades your neighbor's garden?*
- Absence of property rights => problem of excludability (Tragedy of commons).
- We need clear property rights be able to enforce them // externalities.

Different ways to protect property rights

- For non-tangible goods:
 - Patents
 - Copyrights
- Invest in protection: physical resources such as fences.
- Institutionalized protection of property rights: Third party authority with right to use violence.
- Informal institutions.
- Trust / trustworthiness (culture, social norms)

Coase's insight

"If (1) there are no frictions of any sort, and (2) if property rights are clearly defined and transferable, then people can always negotiate to an efficient outcome (no matter who has the right at first, works in every case)." However, in reality property rights are not always well-defined and even when well-defined you still have transaction costs and other negative externalities.

Summary

- *Property rights (bundle of rights) matter, and institutions support them*
- *Form of property (public/private) depends on efficiency considerations (+ideology)*
- *Need them to enforce the continuity of exchange*
- *We need to protect them, different ways to do it*

- *But complicated to do so, and sometimes complicated to allocate them at first*

Lecture 6

Asymmetric information and human behavior

- People do not always behave the way you want them to behave.
- One party has more/less information than the other party.

Hidden information and behaviour

- Opportunistic behaviour more likely when party cannot observe ex-post (after exchange) relevant behaviour of counterparty
 - o Moral hazard (e.g. People start driving less safe after buying car insurance and unhealthy habits.)

Hidden information and type

- Information only known by one of the parties affects ex-ante (before exchange) profitability of transaction for other party
 - o Adverse selection (Health insurance more attractive in case of hereditary illnesses)

P-A theory

- A principal-agent relationship exists when one party, the principal, enlists another party, the agent, to perform certain tasks on the principal's behalf
 - o Principal P owns valuable resource or asset
 - o Agent A works on principal's behalf to turn resource into values products or to enhance value of asset

Principal vs. agents: the "P-A problem"

- Agent's interests \neq principal's interests
 - o Agent want cosy job; principal wants agent to work hard
- Asymmetric information (often but not always)
 - o Principal cannot observe agent's input (eA)
 1. 'hidden-action problem'
 - o Moral hazard

1. Agent pursues own interests over principal's interests
 - Shirking (i.e., avoiding doing what you are supposed to do)

Common solution to P-A problem: Monitoring input/effort

- But... monitoring of agents' inputs is typically imperfect → limits to contractual solution
- Monitoring also costly
 - o Even if possible, perfect monitoring would be prohibitively costly
 1. Costs of measuring performance, drawing up contract, etc.
- Trade-off between costs of monitoring vs. costs of shirking

Alternative: incentives (outcome-based)

- Rewarding individual output rather than individual input
 - o Promotions, bonuses, etc.
- Also property rights as incentives.
 - o Firms where managers have an ownership stake perform better.

Risk aversion and type of contracts

-The risk aversion of the agent is positively related to behavior based contracts and negatively related to outcome-based contracts.

-The risk aversion of the principal is negatively related to behavior based contracts and positively related to outcome-based contracts.

Everything in brief (Kim & Mahoney, 2005)

Lecture 7

Between methodological individualism and methodological collectivism

Culture

- "Those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation." (Guiso et al 2006)
- "The collective programming of the ind that distinguishes the members of one group or category of people form others." (Hofstede and Minkov, 2010)

Characteristics of national cultures (Hofstede and Minkov)

- Power Distance (large versus small), related to solutions for the basic problem of human inequality.
- Uncertainty Avoidance (strong versus weak), related to the level of stress in a society in the face of an unknown future.
- Individualism versus Collectivism, related to the integration of individuals into primary groups.
- Masculinity versus Femininity, related to the division of emotional roles between women and men.
- Long-Term versus Short-Term Orientation, related to the choice of focus for people's efforts: the future or the present and past.
- Indulgence versus Restraint, related to the extent of gratification of human desires for enjoying life.

Culture has an impact on trust and on economic outcomes, preferences, values, beliefs, political views.

Culture and social capital

Coleman: how microstructures in society generate macrostructures? => through social capital.

“Links, shared values and understandings in society that enable individuals and groups to trust each other and so work together.”

Role of social capital

- Social capital help in accessing resources.
- Social capital is related to social identity and can influence behavior.
- Social capital is important when formal institutions are not enough to lower transaction costs/protect property rights.
- Social capital can also lead to social exclusion.



Lecture 8

Political institutions and history are the most important for explaining the evolution of different countries in the world.

North, Wallis, Weingast, 2009

The Democracy ranking goes from a value of 10 to 0. All of the countries tied for first, ranking of 1,

have a value of 10. Those tied second, like France, have ranking of 9. The democracy measure combines information on the quality of political institutions: political access, political competition, and constraints on the executive branch.

Resource curse: a small group has a lot of power over the resource. (like oil)

Table 1.1. Income per capita in 2000 and Polity IV ranking

Rank	Country	Per capita income, 2000	Polity IV rank	Oil
1	Luxembourg	48,217	-	
2	Bermuda	35,607	-	
3	United States	34,365	1	
4	Norway	33,992	1	
5	Qatar	32,261	156	oil
6	United Arab Emirates	32,182	141	oil
7	Singapore	29,434	109	
8	Switzerland	28,831	1	
9	Netherlands	26,293	1	
10	Denmark	26,042	1	
11	Austria	25,623	1	
12	Sweden	25,232	1	
13	Kuwait	25,135	135	oil
14	Hong Kong	25,023	-	
15	Ireland	24,948	1	
16	Australia	24,915	1	
17	United Kingdom	24,666	1	
18	Canada	24,616	1	
19	Iceland	24,339	1	
20	Brunei	24,308	-	oil
21	Macao	24,234	-	
22	Germany	24,077	1	
23	Japan	23,971	1	
24	France	23,672	33	
25	Belgium	23,524	1	
26	Italy	22,487	1	
27	Israel	22,237	1	
28	Finland	21,302	1	
29	Puerto Rico	21,211	-	
30	New Zealand	20,423	1	

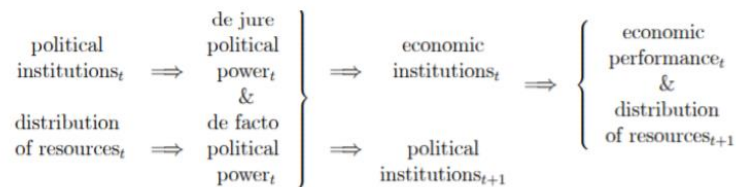
33.

Acemoglu et al., 2004: political institutions matter

Need for inclusive political institutions + centralized power.

Opposite of inclusive political institution is extractive institutions. -> combining rotten

regimes, decentralized states -> low levels of economic development (Congo)



History matters: Path dependence/lock in

Things that are hard to change, because they have been there a long time -> **switching costs**

- It would be too costly to change
- External increasing returns

With institutions: the nature of any equilibrium achieved depends partly on the process of getting there.

- Political institutions are durable, need a big change in the distribution of political power to evolve.
- When a group is rich relative to others, they have more de facto political power.

Patronage, clientelism, and modern countries

Patronage: The support, encouragement, privilege, or financial aid that an organization or individual bestows to another. Patronage can be inefficient and corrupt, but can also function as a repository of trust and security.

Developing countries often operate like a smaller community, like villages. Patronage can help to keep small groups in power by bestowing privileges on each other.

Inclusive political institutions need social cohesion, but that is far from easy.

Lecture 9

Welfare states are very expensive.

Welfare states are about protection against social risks.

Defining welfare states

- Concept of government in which the state plays a key role in the protection and promotion of the economic and social well-being of its citizens.
- Esping-Anderson: It is a matter of rights + how state activities are interconnected with the roles of market and family in terms of social benefits provision.

Esping-Anderson: first one to make comparison between different forms of welfare states and trying to explain why we have differences.

Welfare and markets

Welfare states are depending on 2 important characteristics:

- (1) Decommodification: The possibility of living more or less independently of the labor market.
- (2) Social stratification system: Welfare state is conceived as a mechanism that intervenes and tends to correct the structure of social inequalities.

Importance of context: 3 ideal types of welfare models

	Social-democratic	Liberal	Conservative-corporatist
Aim	Full employment	Economic growth	Economic growth
Social rights	Universal	Individual	Employment-related
Stratification	Universal entitlements for preserving equality	Means-tested programs promoting market in social provision	Insurance-schemes to preserve social rights according to status
Funding	Taxes	Taxes	Contributions
Financial independence of labor market	High	Low	Average
Dominant welfare provider	State	Market	Family + State

In what circumstances have welfare states emerged

(1) Industrial revolution, market economy logic.

- Social consequences
- Linked to the history of social movements

(2) The new concept of individual rights and the concept of nation states.

- Enlightenment
- Private property
- Human progress through collectivity
- Link with the diffusion of capitalism

Some additions (Arts and Gelissen, 2002)

Mediterranean countries (Italy, Greece, Spain) -> no minimum levels of protection + role of religion

Antipodes (Australia and New Zealand) -> more inclusive, more intervention of the state as with wage control

Role of gender -> masculinist/feminist orientation, impact on many policies and possibilities for men and women (parental leave, part-time jobs, households work)

Evolution of different welfare states during the 20th century

Explanation for different welfare states:

- Different amount of wealth, different thresholds of economic development, different ideologies in the government, different abilities of the state to extract resources.
- Control over power resources played a major role in determining the structure of the welfare state. Also organization of politics.
- Importance of path dependence.

Today, Retrenchment of welfare (Pierson)

Policy changes that either cut social expenditure, restructure welfare state programs to conform more closely to the residual welfare state model.

- Mostly the result of economic crisis.

Retrenchment but also persistence (Pierson)

Causes for persistence:

- Shift in the way politicians can act.

Difference between extending benefits to a large number and taking benefits away.

Exercise of blame avoidance.

- The maturation of welfare states.

Link with path dependency, people have a certain level of expectations.

→ resiliency of Welfare.

Crisis in efficiency, funding and legitimacy, but resistance to change, hard to make institutions evolve radically.

Challenges of welfare states:

Globalization:

- Limits the capacity of countries to raise tax rates, given competitive pressure.
- Combined with rapid technological change, accentuates the competitive pressure faced by domestic producers.
- Pressure for migration: lower-income countries to higher-income countries, but also other direction, tax evasion.

Societal changes:

- Evolution of disease, of population size and age, pressure on welfare budget.

Inequalities:

- Increasing inequalities between countries.

Lecture 10

Economic sus (capitalism) characterized by:

-most of the means of production are privately owned

-production for the market

-operation to make a profit

-profit motive, along with inheritance law, and supported by contract law, forms the driving force of capitalism

Two key concepts in Variety of Capitalism (VoC)

1. Institutional complementarities: Two institutions can be said to be complementary if the presence (or efficiency) of one increases the returns from (or efficiency of) the other
2. Comparative institutional advantage: The institutional structure provides firms with advantages for engaging in specific types of activities (Cf. standard H-O trade theory)

Institutional comparative advantage

- Nationally distinct patterns of economic performance and specialization across different industrial sectors.
 - o Example: Schneider et al. with high tech and medium tech firms performance.
- Different types of institutions give rise to distinct forms of comparative advantage, not a single best set of institutional arrangements.
- Implications for government policy + location choices for multinational enterprises.

Institutional differences → Differences in degree of coordination.

Liberal Market Economy: Less coordination, more competition.

Coordinated Market Economy: More coordination.

Dimensions of VOC	LME	CME
Financial regulation	Short-term financial market	Long-term patient capital
Training and education	Emphasis on general education	High levels vocational training
Labour market	Deregulated	Cooperative industrial relation
Competition	Strong product market comp.	Weakened product comp.
Comparative advantage	Radical innovation (fast adaptation to changes)	Incremental innovation (cumulative knowledge of skills)

Welfare state:

Liberal Market Economy (LME):	Coordinated Market Economy (CME):
-------------------------------	-----------------------------------

<ul style="list-style-type: none"> • Only partial developed welfare state. • Social benefits mainly contributed by private investment. • Decommodification low. • Taxes low. 	<ul style="list-style-type: none"> • Fully developed welfare state. • Social benefits mainly contributed by employer or state. • Decommodification medium – high. • Taxes high.
--	---

Institutional complementarity → performance

- CMEs = relational assets = long-term perspective = need for different sorts of institutional supports.
- Complementarities = features of institutional structures reinforce each other by mutually generating increasing returns.
- Coherence = institutions follow the same market or coordinated logic across domains of the economy.
- Countries with lower levels of coherence – “mixed types” – lack the institutional complementarities needed for institutional comparative advantage.

State capitalism(Bremmer, 2010)

- Capitalist enterprise = part of the state bureaucracy => the receivers of capitalist surplus value are state appointed bureaucrats
- Planning the economy to maximize state’s profit

Governments use various kinds of state-owned companies to manage the exploitation of resources. Using selected privately owned companies to dominate in certain economic sectors.

Creation of funds to maximize investments:

- Ultimate motive is not economic but political
- The state acts as the dominant economic player and uses markets primarily for political gain.

Example of workers training

<p>LMEs</p> <p>Workers are in charge of funding their own education.</p> <p>Because few barriers to workers switching jobs</p>	<p>CMEs</p> <p>Barriers to labor mobility.</p> <p>State-supervised negotiations between industry and labor unions.</p> <p>→ allows firms to invest in very specialized</p>
---	---

<p>so there's little incentive for firms to invest in the training of their workers.</p> <p>→ easy for competitor to just hire workers that some other company trained.</p> <p>→ so, factory workers are trained in generic skills at tech colleges, meaning that the machines they work on have to be more generic and less specialized.</p>	<p>training.</p> <p>→ allow workers to use very advanced machines to be more productive.</p> <p>→ but, as a result, it takes workers longer to get up to speed when they join the firm.</p>
---	---

Another related framework, the school of regulation

Complementarity between 5 fundamental institutions forms.

- Form of competition (degree of concentration, price formation, competition between employees, which then determines wages).
- Form of money (currency, monetary policy, financing of the economy, etc.).
- Form of the state (economic and social intervention).
- Form of the wage relationship (determinants of wages and employment, work organization, etc.)
- Form of integration into the global economy (trade, financial and monetary relations).

Another type of accumulation of capital: Rentier states (Hazem Al Beblawi + regulation)

- Rentier states are countries with bad institutions, most often countries with lots of a specific natural resource.
- Rent situations predominate. (Rent: the predominate resource in a country, example: oil)
- Does not require a strong domestic productive sector. Because only a small proportion of the working population is actually involved in the generation of the rent. Which is enough to create large revenue.
- The states government is the principal recipient of the rent.
- Relative absence of revenue from domestic taxation, wealth from rent precludes the need to extract income from their citizenry.
- Rente is dependent to international prices, need constant generation of money to distribute (//clientelism and inflation).

→ Rentier mentality

- In the absence of taxes, citizens have less incentive to place pressure on the government or become responsive to their needs.
- Instead, the government essentially 'bribes' the citizenry with extensive social welfare

programs, becoming an allocation or distributive state.

- Governments that rely to a significant extent on revenues from non-market sources are not compelled to apply free market principle to create an environment conducive to economic growth (rule of law, security, a fair and transparent judiciary and property rights).

Lecture 12: application case 2

Coase Theorem and negative externalities

Coase's insight: if (1) there are no frictions of any sort and if (2) property rights are clearly defined and transferable, then people can always negotiate to an efficient outcome (no matter who has the right at first, works in every case)

Athur Pigou and taxes

When Coases wrote his paper, the Pigouvian tradition of social cost analysis was firmly established

Pigou: The government should intervene directly through centralized instruments:

- Quantity regulation (bans)
- Monetary tools

Coase against Pigou

For coase this approach generally ignores the cost and administrative difficulties with the implementation of such schemes

Three possibilities for dealing with externalities

- In case of producer-producer externalities, control under a single firm of the externality-relevant activities
- direct government regulation but costly, may be impacted by political pressures, possible inefficient policy judgments
- coase suggests that the best solutions may be 'to do nothing about the problem at all'

The basic problem of economic policy, according to Coases, "it is to consider how alternative social institutions would work in practice-and to evaluate their performance"

- ➔ Market failures < government failures -> use of market mechanisms

Quizzes

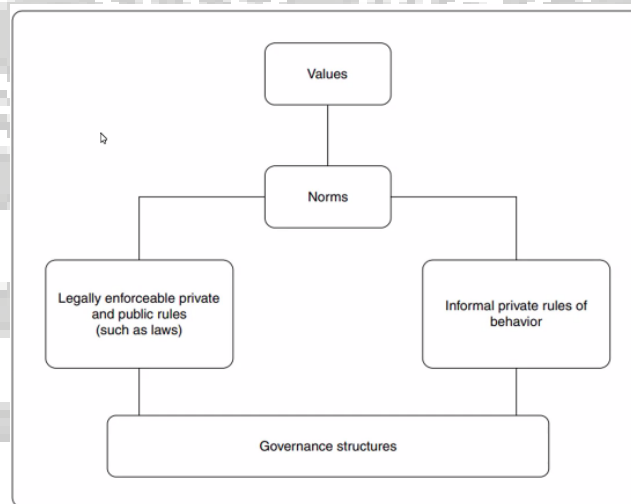
Summary lecture:

main concepts of the course:

you need to explain the main concepts and give examples

- **What are institutions?**

Institutions are going into directions, they are man-made rules but ones in place, they can also influence us



- **Between OIE and NIE**

Explaining the different levels and seeing the correlations

Difference between informal and formal

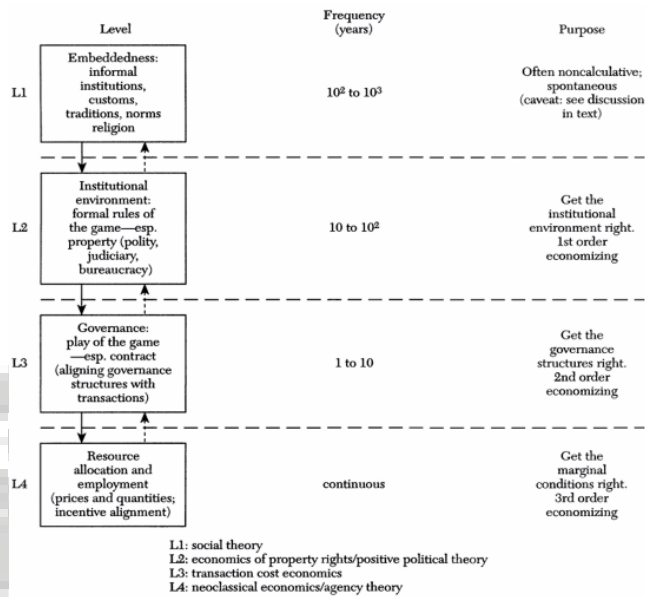
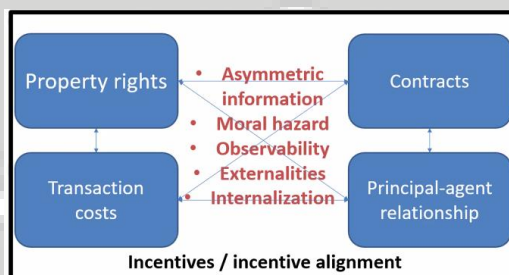


Figure 1. Economics of Institutions

Governing economics exchanges

- Difference between hold-up and moral hazard. Hold-up is not part of asymmetric information but it does mean that one party changed their behavior afterwards. (asymmetric bargaining power)
- Coase theorem -> to protect property rights



Market failures

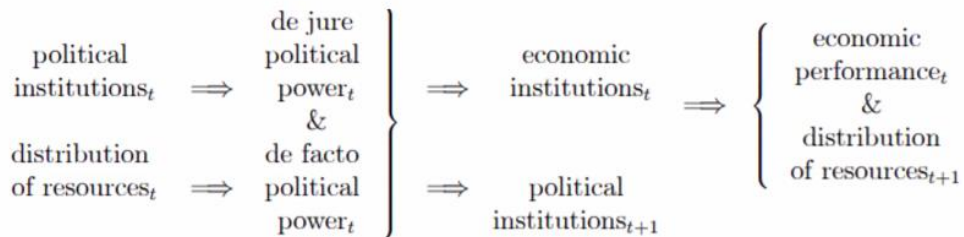
- Transaction costs
- Externalities
- Free-riding
- Opportunism
- Inequalities and commodification of labor

		Excludable from consumption	
		High	Low
Rivalry in consumption	High	A. Individual (private) goods Food, clothing, car, house	B. "Common pool resources" Water, nature, environment
	Low	C. Club goods Swimming pools, telephone network, cinemas, unions	D. Collective (public) goods Defence, dykes, legal protection, sunshine, search engine

- From informal to formal institutions



- Inclusive/extractive political institutions -> inclusive/extractive economic institutions
Path dependence, institutions may evolve but durable



- Hall and Soskice, variety of capitalism and comparative institutional advantages

Dimensions of VoC	LME	CME
Financial regulation	Short-term financial markets, equity Financing	Long-term patient capital, debt financing
Training and education	Emphasis on general education	High levels of vocational training
Labour market	Deregulated	Cooperative industrial relations
Competition	Strong product market competition	Weakened product market competition
Comparative institutional advantage	Radical innovation Fast adaptation to changing market conditions	Incremental innovation Cumulative accumulation of knowledge and company-specific skills

- **Welfare, between decommodification and social stratification**

Welfare State:

Liberal market Economy (LME):

- Only partial developed Welfare state
- Social benefits mainly contributed by private investment
- Decommodification low
- Taxes Low

Coordinated market economy (CME):

- Fully developed Welfare state
- Social benefits mainly contributed by employer or state
- Decommodification medium – high
- Taxes High

Exam:

- On campus with cirrus
- January 18, 12.45-15.45
- 3 hours
- 25 MQ's (50%) and 3 open questions
 - o 2 appliation questions with sub-question(explain concepts in your own words, apply the concepts) (bonus assignments)
 - o 1 broader question, asking a deeper thinking (in-class assignments)
- Exam material: lectures + slides, quizzes and seminars
- Not exam material: texts are complementary, helps to understand further, but no question about stuff we didn't not talk about together in lectures or seminars. And applications cases. It was to show you how the concepts we have seen together matter for research and policy.

Mentimeter Lecture 3

Defines institutitons?

A "humanly devised constraints that structure human interaction"

B “Regulatory normative and cognitive structures and activities that provide stability and meaning to social behavior”

C both

D neither

Answer C

Regarding the figure of Williamson, OIE is more related to:

A L1 and L2

B L2 and L3

C L3 and L4

D old institutional economics is not concerned by this figure

Answer A

Collective entities and collective action can be fully understood by analyzing the actions of the individual agents involved?

A True

B false

Answer B

Consider the form of exchange between different entities. Which one is reciprocity, redistribution, market exchange, householding?

A ⇔ A Exchange between 2 entities is

A reciprocity

B redistribution

C market exchange

D householding

Answer C market exchange

A ⇔ B/C/D (A can be seen as the government and the rest as citizens) is

A reciprocity

B redistribution

C market exchange

D householding

Answer is B redistribution

A->B/C/D is

A reciprocity

B redistribution

C market exchange

D householding

Answer A reciprocity

A->A (something you produce for yourself, like food) is

A reciprocity

B redistribution

C market exchange

D householding

Answer D householding

Mentimeter Lecture 4

Trade union

A low excludability, low rivalry

B low excludability, high rivalry

C high excludability, low rivalry

D high excludability, high rivalry

Answer C

A pack of fancy beers bought in Albert heijn

A low excludability, low rivalry

B low excludability, high rivalry

C high excludability, low rivalry

D high excludability, high rivalry

Answer D

Fish stocks

- A low excludability, low rivalry
 - B low excludability, high rivalry
 - C high excludability, low rivalry
 - D high excludability, high rivalry
- Answer B

National defense

- A low excludability, low rivalry
 - B low excludability, high rivalry
 - C high excludability, low rivalry
 - D high excludability, high rivalry
- Answer A

Transaction costs are higher in simultaneous exchange compared to non-simultaneous exchange.

- A true
 - B false
- Answer B

Freeriding involves a negative externality in the same way that smoking does.

- A true
 - B false
- Answer A

Because of the private cost and social cost, the private costs are lower than the social cost

Why many purchases, e.g., a holiday in Hawaii or a hotel room, include some sort of prepayment?

- A Because the exchange is not simultaneous
- B Because of opportunistic behaviors
- C Because of the hold-up problem
- D All of these explanations

Answer D

Holiday resort Carpe Diem (C) is located down-wind from pig farm Hogs (H).

Hogs emits smelly gases as part of raising pigs. Although these gases do not pose a health risk, they are a nuisance to guests at Carpe Diem. When atmospheric concentration of the gases, measured in parts per million or PPM, is high, some guests are willing to stay at Carpe Diem but only at a reduced rate. The payoff below gives the daily profits of C and H at full rates and reduced rates respectively and at high vs. low pollution rates respectively.

		Charge full rates	Charge half rates
Hogs (H)	Low pollution, 1 PPM	€1000 for H, €2000 for C	€1000 for H, €1000 for C
	High pollution, 2 PPM	€1500 for H, €0 for C	€1500 for H, €500 for C

A) Is this payoff matrix reflecting the presence of a negative externality?

A yes

B no

Answer A

b) What is the Nash equilibrium of this game?

A 1000;2000

B 1000;1000

C 1500;0

D 1500;500

Answer D

Mentimeter lecture 5

Read the following extract from an article of 2018

“Boeing will continue its aggressive push to launch more joint ventures with parts suppliers and make other jet components itself, CEO Dennis Muilenburg said this week. Boeing's moves to bring more parts and component work in-house can help control the quality, quantity and cost of key passenger jet parts while boosting the company's profit.”

What is this extract showing?

A A progressive vertical integration

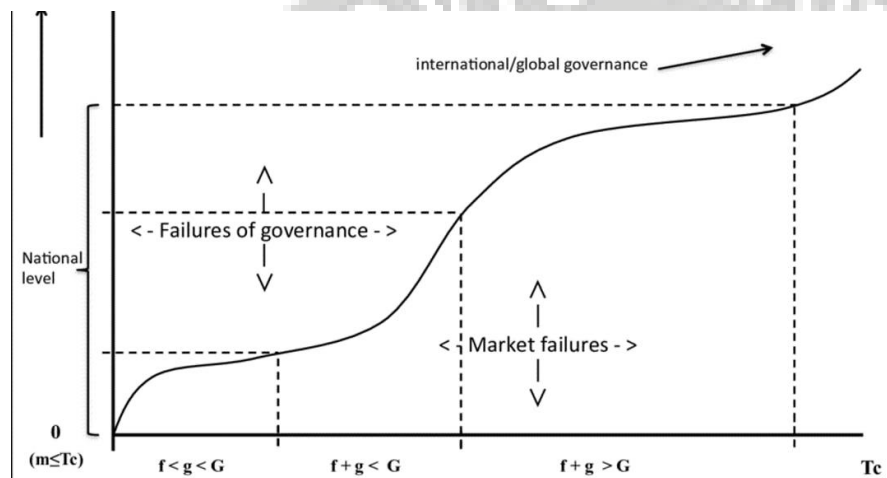
B More market regulation

- C A mix between more hybrid governance and vertical integration
- D More hybrid governance

Answer C

Firms exist because markets fail.

- A True
 - B False
- Answer A



In this figure from Underhill, what is the zone below the optimal line reflecting? (press S to show image)

- A Sub-optimal pattern of market exchange: Too much competing self-interest of interacting agents, not enough cooperation
- B Sub-optimal governance scenarios: not enough competition, firms or governments take advantage of their dominant position

Answer A

Read the following extract

'I can trust Albert Heijn to do a good job because if they would cheat their customers they would ultimately be driven out of the market.'

What is the type of safeguard in this example?

- A Market safeguard
- B Administrative safeguard

Answer A

Mentimeter lecture 6

True or false? Even when property rights are well-defined, there can still be externalities

A True

B False

Answer A

Ben and Jerry are roommates, living together in a dormitory. Ben loves to listen to classical music, which is not the case for Jerry. The problem causes Jerry to contemplate moving out, in which case both Ben and Jerry would have to be renting more expensively elsewhere. Ben has the right to listen to classical music.

In light of the Coase theorem, what do you expect to happen?

A Ben is going to pay Jerry to be able to continue to listen his music

B Jerry is going to pay Ben for him to stop listening to this music

C Jerry is going to move out

Answer B "ben has the right to listen to music"

Consider the paper from Hart et al. (public versus private ownership). Do you think hospitals should be public or private?

A Public

B Private

Answer A

What about weapon procurement for the army and police?

A Public

B Private

Answer B has positive effect on innovation and quality

Mentimeter lecture 7

True or false: “Getting an educational degree is a way in which prospective employees can lessen the problem of adverse selection for employers.”

A True

B False

Answer A

True or false: “Asking for a deposit is a great way in which landlords can reduce the problem of moral hazard among their tenants.”

A True

B False

Answer A

Table 3. Partitioning of variance in performance: maximum likelihood estimation

Variable	Country	Percent of variance attributable to:					
		Year	Industry	Company	CEO	Error	Total
ROA	U.S.	3.96	7.66	6.55	30.44	51.39	100.00
	Germany	1.69	5.77	17.70	23.91	50.92	100.00
	Japan	13.87	8.02	12.04	10.33	55.73	100.00

Crossland and Hambrick (2007)

This table shows the power different factors have on the ROA (return on assets) of firms in different countries (the column CEO shows the power of CEOs in influencing the ROA compared to other factors).

On the basis of this table, in which country or countries do you think that CEOs are more willing to accept an outcome-based contract? (two options)

A US

B Germany

C Japan

Answer A B (look at CEO column)

True or false: Outcome uncertainty is positively related to behavior-based contracts and negatively related to outcome-based contracts

A True

B False

Answer A

True or false: Outcome measurability is positively related to behavior-based contracts and negatively related to outcome-based contracts

A True

B False

Answer B

Mentimeter lecture 8

In the characteristics of national cultures, a society willing to maintain its traditions and view societal change with suspicion has:

A short-term orientation

B masculinist orientation

C individualist orientation

D high power distance orientation

Answer A

Table 1

Effects of Variables on Probability of Becoming an Entrepreneur
(robust standard errors in parentheses)

	Ordinary least squares (no income decile dummies)	Ordinary least squares (with income decile dummies)
Trust	0.0151*** (0.0043)	0.0167*** (0.0046)
Respondent is male	0.0708*** (0.0040)	0.0697*** (0.0043)
Respondent is white	0.0438*** (0.0048)	0.0435*** (0.0051)
Age of respondent	0.0055*** (0.0007)	0.0049*** (0.0007)
Age of respondent squared	-0.0000*** (0.0000)	-0.0000*** (0.0000)
Education	-0.0096*** (0.0032)	-0.0068* (0.0035)
Education squared	0.0004*** (0.0001)	0.0003** (0.0001)
Income deciles dummies	NO	YES
Observations	26,326	22,791

Here is a table taken from Guiso et al. (2006). What is this table showing?

A Trust is an important factor to explain the decision to become entrepreneur

B Social capital is an important factor to explain the decision to become entrepreneur

C Both of them

Answer C (first row is trust. Social capital belongs to gender, age, education)

Which type of intervention by school management is most likely to increase the educational achievements of children at a primary school?

- A Organize discussion meetings between parents and teachers
- B Order the newest methods for reading and writing
- C Increase the salary of teachers

Answer A

True or false: economic and/or social outcomes arising from social capital are always positive

- A True
- B False

Answer B

Figures A and B represent two different networks of drug users who share needles with each other. Figure A shows sparse social relationships. Figure B shows many social relationships on the contrary. A healthcare organization wants to start a program aimed at increasing safe drug use and preventing the spread of disease. However, they only have limited funding available.

Which network should the organization target, to try to influence the behavior of a maximum number of drug users, and why?

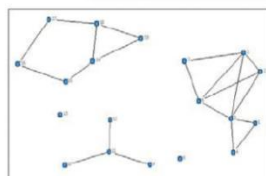


Figure A

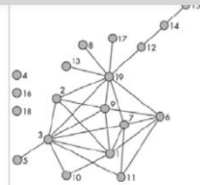


Figure B

A The organization should target the network depicted in figure A, because it is easier for information and norms to spread in loose-knit networks

B The organization should target the network depicted in figure B, because it is easier for information and norms to spread in dense networks

Answer B

Mentimeter lecture 10

What is a possible characteristic of welfare that Esping-Anderson does not include in his analyze?

- A Relationship with markets
- B Gender
- C Inequalities

D Role of family

Answer B

What is a characteristic of corporatist welfare states?

A The aim is full employment

B Funding is done through taxes

C Social rights are employment-related

D None of them

Answer

Medicaid in the US is a type of health coverage for low-income residents. Is this program aligned with:

A Social-democratic welfare?

B Liberal welfare?

C Corporatist welfare?

Answer B

In the Netherlands, private insurance companies must offer a core universal insurance package. They must do this at a fixed price for all. Is this:

A Social-democratic welfare?

B Liberal welfare?

C Corporatist welfare?

Answer A

In France, health coverage is provided, in part, by what we call mutuelles (associations dedicated to health care). Civil servants can contribute to a specific mutuelle, MGEN, students contribute to another one, LMDE, and employees can subscribe to a mutuelle attached to the sector they work in. Is this:

A Social-democratic welfare?

B Liberal welfare?

C Corporatist welfare?

Answer C

Mentimeter lecture 12

True or false: If institutions are complementary, the economic/political/social system of a country is coherent

A True

B False

Answer A

A strong European competition authority may have a positive effect on CME type of European countries according to Hall and Soskice framework.

A True

B False

Answer B

True or false: rentier state theory explains why those countries do not have democracies.

A True

B False

Answer A

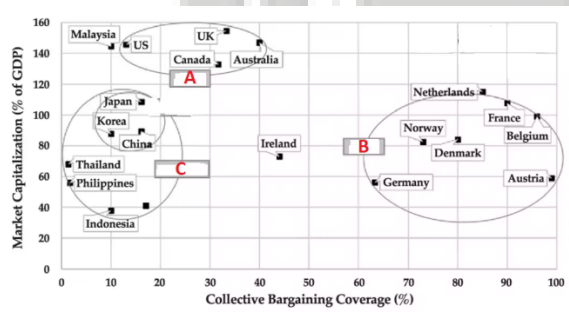
True or false: LMEs are showing a better economic performance.

A True

B False

Answer B

Kalinowski and Jang (2014) established types of capitalism in different countries according to collective bargaining power on one side and market capitalization (marker-based financial system) on the others. Fill the blanks establishing which group of countries is which type of capitalism according to Hall and Soskice.



A is...

A LME

B CME

C Mixed

Answer A

B is...

A LME

B CME

C Mixed

Answer B

C is...

A LME

B CME

C Mixed

Answer C



Disclaimer

ESV Nijmegen makes an effort to keep the content of this summary up to date and where needed complements it. Despite these efforts it is still possible that the content is incomplete or incorrect. The offered material is a supplement for studying next to the appointed literature. The material is offered without any guarantee or claim for correctness.

All rights of intellectual property concerning these summaries are owned by the ESV. Copying, spreading or any other use of this material is not allowed without written permission by the ESV Nijmegen, except and only to the extent provided in regulations of mandatory law, unless indicated otherwise.

