

Institutions, power, and inequality

Session 11

PMAP 8141: Microeconomics for Public Policy
Andrew Young School of Policy Studies

Plan for today

Institutions

Institutions, paths, and history

Institutions

Institutions

Laws

Rules

Regulations

Customs

Norms

Moral injunctions

Earth 2.0: What Would Our Economy Look Like? (Ep. 283)

April 12, 2017 @ 11:00pm

by **Stephen J. Dubner**

Produced by: **Stephanie Tam**



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Our latest Freakonomics Radio episode is called “Earth 2.0: What Would Our Economy Look Like? (Earth 2.0 Series)”. (You can subscribe to the podcast at [iTunes](#) or [elsewhere](#), get the [RSS feed](#), or listen via the media player above.)

If we could reboot the planet and create new systems and institutions

Economists used to ignore institutions

Pragmatic reasons

Institutions change slowly; no reason to worry about them

Ideological reasons

Human progress is the emancipation from constraints on behavior. Liberty & freedom = no constraints

Adam Smith: if A wants to sell something to B, there shouldn't be any constraints

Buuuuuut...

**The whole Smithean
premise falls apart in the
absence of constraints**

No property rights?
No right to transfer property?
No liability for contract breaches?

Ways of seeing institutions

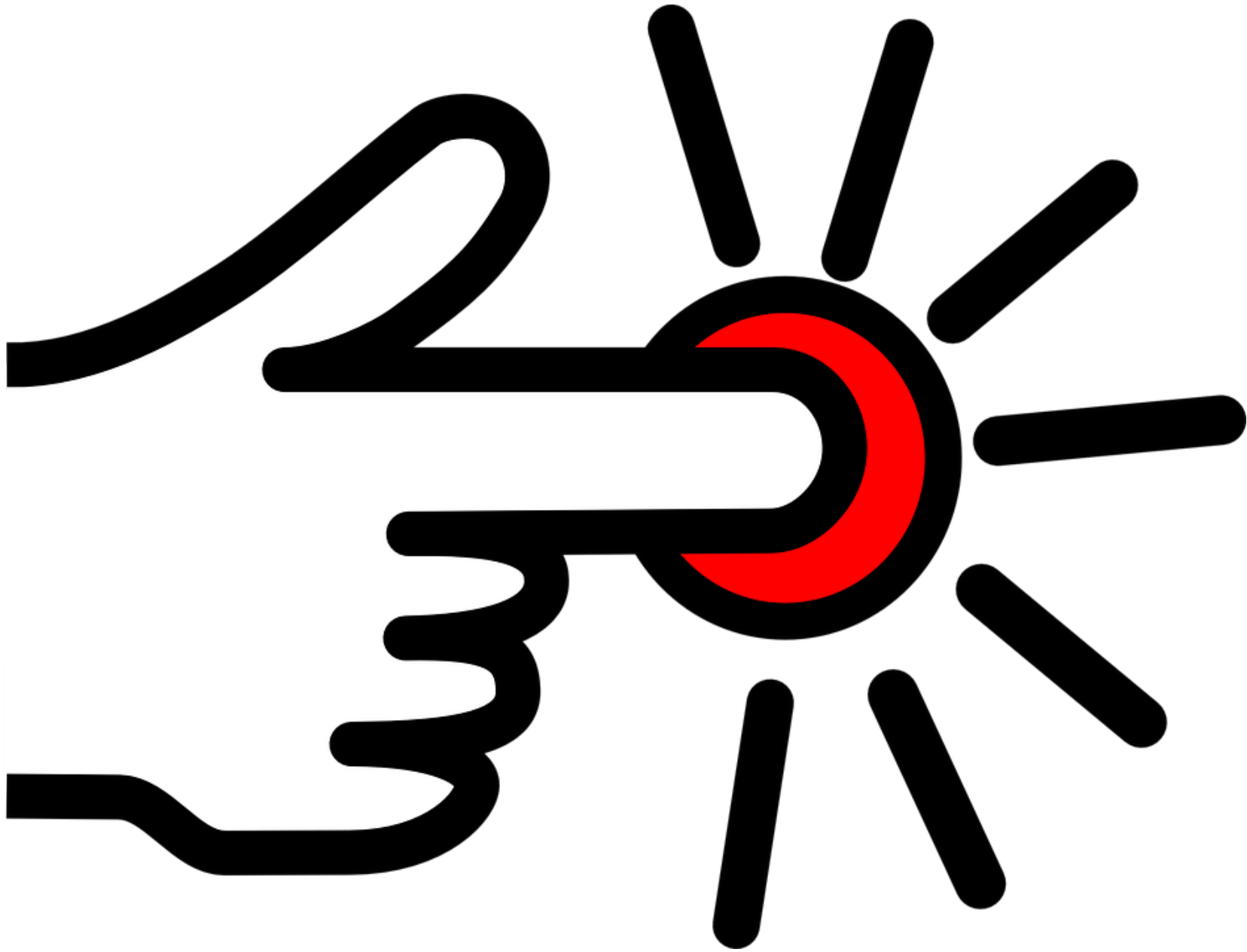
Rational behavior

Constraints

Temporary equilibria

Institutions as rational choices

People cooperate because of their rational utility functions





Institutions as constraints

**Socially imposed constraints
on human activity**

Rules and norms

**“Humanly devised constraints
that shape human interactions”**

Institutional formality

Formal institutions

Codified expectations backed by enforcement mechanisms; laws

Informal institutions

Expectations that aren't codified or backed with formal enforcement (but still with punishment!);
etiquette, customs, conventions



Jennifer Victor ✓

@jennifervictor

Following



Things that irk me #47: “Generous” drivers who violate right-of-way, in an effort to be kind to others, but who really disrupt the norms that keep our roads from being utter chaos. THE NORMS CREATE PREDICTABILITY; VIOLATING THEM ISN’T POLITE.

4:40 PM - 18 Sep 2018

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31

59

436





Jennifer Victor ✓

@jennifernvictor

Following



Replying to [@markchildress](#)

In a zipper-merge situation with a lane closure, **all** traffic moves more efficiently if drivers in the disappearing lane go all the way to the merge point, then alternate with the other lane. Getting in line further back, at random points, is Pareto suboptimal.

7:36 PM - 18 Sep 2018

4 Retweets 39 Likes



Informal institutions

Wearing a hat in church

Tipping at a restaurant

Tipping at a hotel

Lawns

Formal wear

Corruption

Footbinding

Are formal or informal institutions more powerful?

There's no clear divide between formality and informality

Institutions as temporary equilibria

**Why do people follow some rules,
ignore other rules?**

Rules meet game theory



Institutions are the outcomes of games

Decisions based on
payoffs, repetition, etc.

Self-enforcing

Self-reinforcing

Self-undermining

Self-enforcing institutions

Stable, Nash equilibrium

		Bala	
		Left	Right
Anil	Left	Live, Live	Die, Die
	Right	Die, Die	Live, Live

Self-enforcing institutions

Not always life or death

**What's the norm for when
two people crash at a door?**

Older person first?

Woman first?

Repeat a lot = cultural norm emerges

Self-reinforcing institutions

**Institution/equilibrium
entrenches itself**

Codified road signs

More right-sided cars

Too hard and costly to change

Self-undermining institutions

Institution/equilibrium deteriorates

Tourists from other-sided
countries hate coming

Tourism industry suffers

People agitate for change

Summary of institutions

Rational choice

ignores external factors

Institutions-as-rules

doesn't explain changes or emergence
or uneven enforcement

Institutions-as-equilibria

saves the day

Institutions, paths, and history

Northian institutions

Institutions = rules of the game

Institutions reduce uncertainty by regularizing human interactions

North's argument

Institutions determine opportunities available in society

Organizations emerge to take advantage of opportunities

As organizations evolve, they alter the institutions in their favor

Pólya's urn

Path dependency and institutional lock-in

Underlying institutional
framework shapes incentives

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