

PSCI 4012

Global Development

Economic Institutions and Development

Erkan Gunes
University of Colorado Boulder

Today's Plan

- What are institutions?
- Economic institutions and economic growth
- How does institutional change happen?
- Group discussion

Institutions

- North (1990) : “Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction”
- Examples of economic institutions: property rights, presence and perfection of markets etc.
- Examples of political institutions: electoral systems, regime type etc.

Institutions

Federalism example:

- In a federal system, subnational administrative units have law and policy making autonomy
- How does federalism affect political and economic interaction within a society?
- Does federalism have any consequences on economic activity?

Economic Institutions and Development

- Extractive Institutions vs. Inclusive Institutions
- Extractive institutions: “institutions under which the rule of law and property rights are absent for large majorities of the population” (Acemoglu and Robinson, 2001)
- Economic institutions shape the incentives. If there are extractive institutions there is low incentive for investment in physical and human capital. If there are inclusive institutions, there is high incentives for investment in physical and human capital.

Economic Institutions and Development

- Economic and political institutions affect the size of the aggregate pie (size of the economic output), but also how the pie is divided (distribution of economic output among the population)

$$\text{economic institutions}_t \Rightarrow \begin{cases} \text{economic performance}_t \\ \text{distribution of resources}_{t+1} \end{cases} .$$

Economic Institutions and Development

Figure 14
Log mortality of potential European settlers
and average protection against risk of expropriation 1985-95



Economic Institutions and Development

Figure 15
Log mortality of potential European settlers and log GDP
per capita in 1995



Institutional Change

- What determines economic institutions?
- Acemoglu, Johnson, and Robinson (2004)

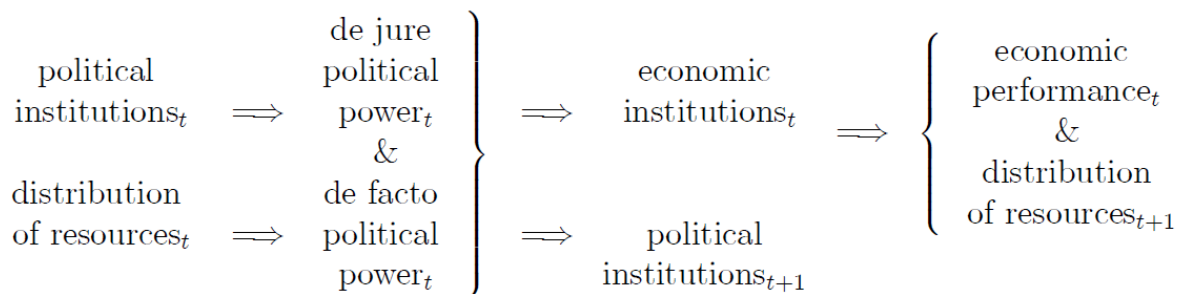
political power_t \implies economic institutions_t

Institutional Change

- Two types of political power:
 - de jure political power : “power that originates from the political institutions in society”
 - de facto political power: political power determined by the ability to solve collective action problems and the distribution of resources
- “If political institutions place all political power in the hands of a single individual or a small group, economic institutions that provide protection of property rights and equal opportunity for the rest of the population are difficult to sustain”

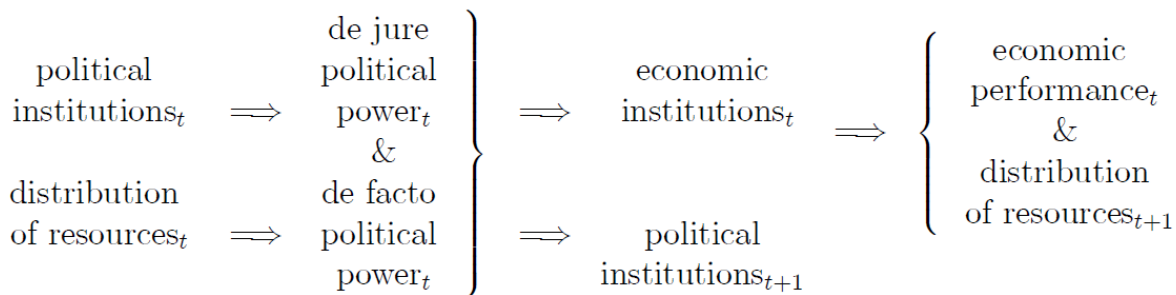
Institutional Change

The cycle of institutional change



Institutional Change

- If a society starts with an extremely unequal distribution of resources, the below diagram suggests they will end up with a vicious cycle of extreme inequality and bad institutions that reinforce each other.
- Question: What can break such a vicious cycle?



Institutional Change

- This cycle is typically broken by a dramatic event such as a war or a revolution
 - The Glorious Revolution
 - The French Revolution
 - The Jasmine Revolution
 - The First and Second World Wars

Institutional Change

2008 Financial Crisis and Institutional Change



Group Discussion

- The cycle can also be broken by technological change that slowly changes the distribution of resources within a society
- Today we are undergoing rapid technological change. Does this process change the distribution of resources?
- What might be consequences of this process on political and economic institutions?