

# INSTITUTIONS, POWER, & INEQUALITY

PMAP 8141: Economy, Society, and Public Policy

October 24, 2019

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on iCollege!*

# PLAN FOR TODAY

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## Institutions

### Institutions, paths, and history

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# INSTITUTIONS

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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



LISTEN NOW:



*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 hate 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

B U U U U U U U U T

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The whole Smithian  
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

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Rational behavior

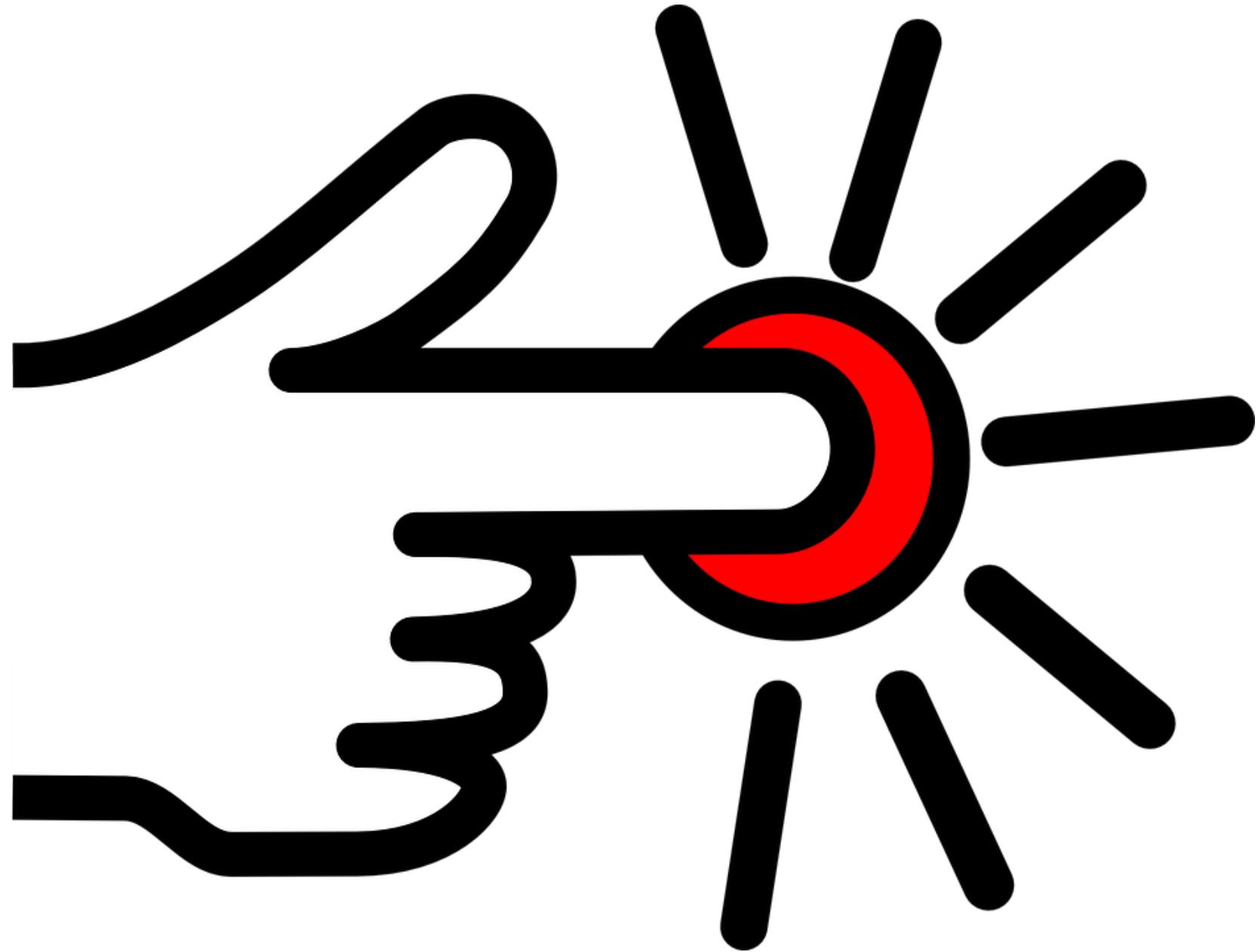
Constraints

Temporary equilibria

# INSTITUTIONS AS RATIONAL CHOICES

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People cooperate because of  
their rational utility functions





# INSTITUTIONS AS CONSTRAINTS

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**Socially imposed constraints  
on human activity**

**Rules and norms**

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

# INSTITUTIONAL FORMALITY

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## 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

@jennifernvictor

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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59 Retweets 436 Likes



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

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4 Retweets 39 Likes



6

4

39



# INFORMAL INSTITUTIONS

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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

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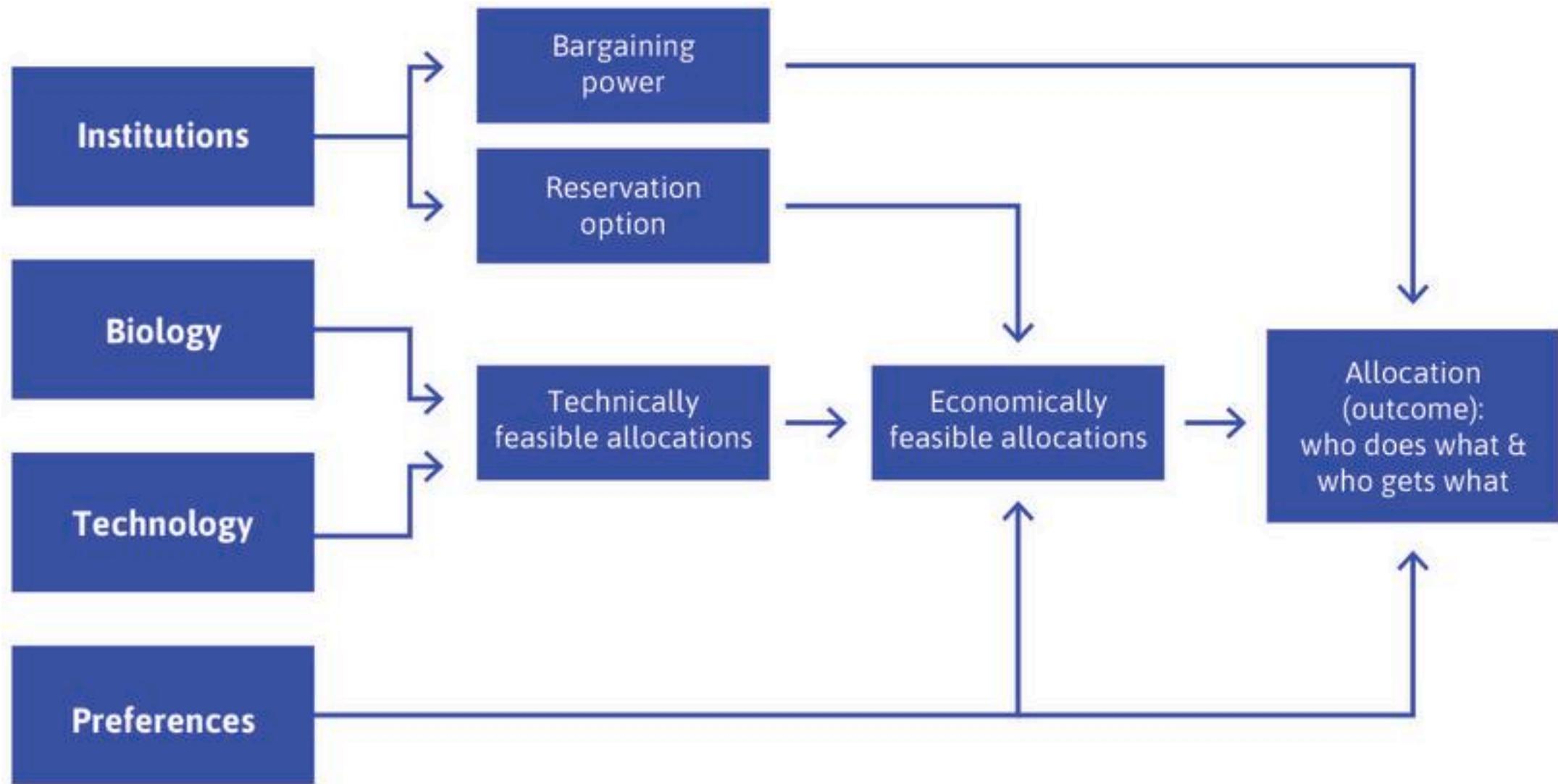
Why do people follow some rules,  
ignore other rules?

Rules meet game theory



# INSTITUTIONS & GAMES

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# Institutions are the outcomes of games

Decisions based on payoffs, repetition, etc.

Self-enforcing

Self-reinforcing

Self-undermining

# SELF-ENFORCING INSTITUTIONS

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Stable, Nash equilibrium

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

# SELF-ENFORCING INSTITUTIONS

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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

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Institution/equilibrium  
entrenches itself

Codified road signs

More right-sided cars

Too hard and costly to change

# SELF-UNDERMINING INSTITUTIONS

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Institution/equilibrium  
deteriorates

Tourists from other-sided  
countries hate coming

Tourism industry suffers

People agitate for change

# SUMMARY OF INSTITUTIONS

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**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

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**Institutions = rules of the game**

Institutions reduce uncertainty by  
regularizing human interactions

# NORTH'S ARGUMENT

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Institutions determine  
opportunities available in society

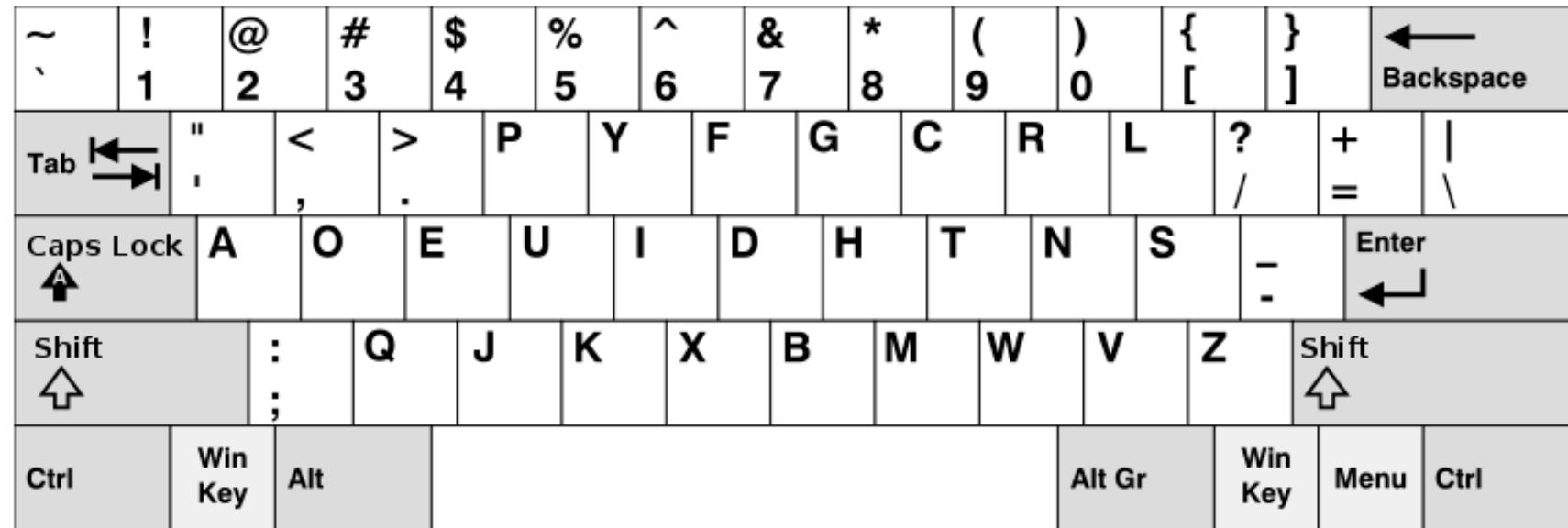
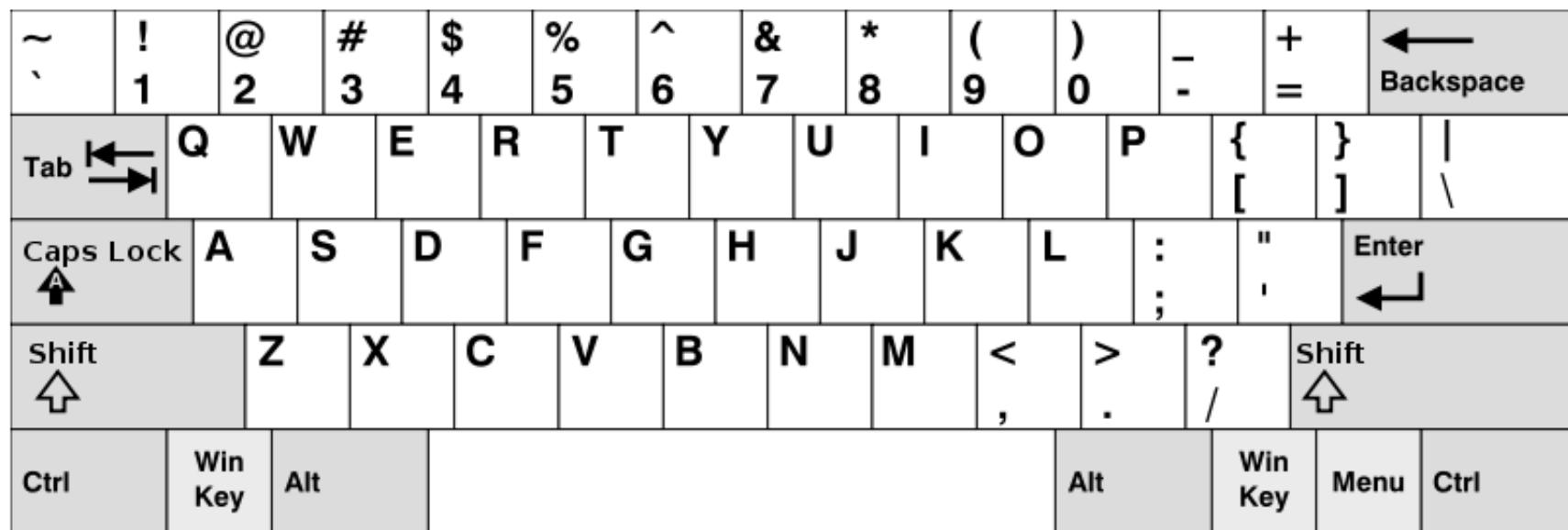
Organizations emerge to take  
advantage of opportunities

As organizations evolve, they alter  
the institutions in their favor

# Pólya's urn

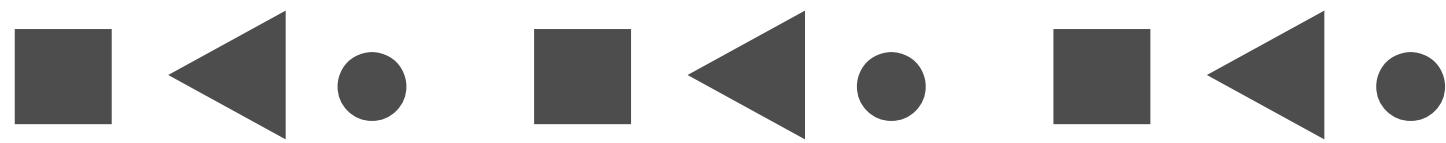
# Path dependency and institutional lock-in

Underlying institutional framework shapes incentives









**Each group is a sovereign country.**

**Make as much money as possible  
using the materials in the envelope.**

**Manufacture shapes.  
Shapes must be cut with scissors  
and must be accurately measured.**

The more shapes you make,  
the richer you get!

Only cut blank white paper.

No physical violence.

I adjudicate disputes and my word is final.

That's all. Go get rich.

