Individual Incentive and Institutional Structure

The role of actors is inherently dependent on the societal structure of a given community, and institutions that incentivize the individual. Economic and political institutional ramifications influence the role of the individual, but while consensus is reached on this point, Adam Smith, David Ricardo, Clive Crook, Douglas North, and David Acemoglu take different perspectives on the incentives and influences of the individual. Each author does not directly reference members of society in the same manner; however, individual incentives are vital to the arguments that each author makes.

Self-Interested Actors and the Invisible Hand

Adam Smith describes that markets are fundamentally self-regulating, and that this is primarily the cause of individuals acting in their self-interest. Because economic interdependence relies on each individual serving a certain role for the greater whole, Smith argues that the sum of the parts in an institution is equal to the whole of the economic structure. Individuals act on the perceived gain from individual action with zero motivation deriving for the collective good. In other words, societal implications are irrelevant to individual actors. Individual incentive is determinate on the reward to the individual for finishing a task that the market posts a reward for. Individuals meet certain requirements through specializing their efforts, and benefit through compensation. Smith effectively describes that, through the manner of exchange, tasks are completed and individuals trade to meet their needs.

States as Individuals and Individual Member Advantages

Similarly, states act as an individual actor in an international context. Due to differences in relative advantages, some states efficiently produce some goods or services better than other states. The comparative advantages that some states have in relation to other states incentivize states to produce certain products for trade. David Ricardo finds that states specialize their production for increased overall profits. Individual members of a state society are confined to the goods that states trade with each other. While Ricardo mentions states as the central unit of analysis, the implication of the individual is relative to the institutional context that person is entrenched in. Thereby, the individual incentive is one of self-interest to participate in industry that the state endorses through trade with other states. For example, if the individual produces a particular good that is exported, the individual will likely have an increased profit due to the comparative advantage of the exporting state.

The Negative Externalities of Individual Actors

Clive Crook accounts that individuals have the capacity of influencing the overall market, and therefore alludes to the impression of the greater whole being less than the sum of its parts. If institutions are influenced from individuals, then market forces forces change to reconstitute balances in the market. Yet, if individuals perceive gain and create real losses, the market may not have the capacity to account for negative externalities. Said differently, Crook depicts that new trade could increase production, lower prices of goods and services, and outweigh gains from cheaper imports. Clive Crook covers the idea of externalities in context to states and global exchange; although similarly to David Ricardo, Crook relates individual incentive as a derivative from the institutions of states.

Path Dependency and Complex Institutional Structure

In some cases, institutions do not develop in the same fashion to that of the west due to the lack of institutional incentives. Douglas North refers to three possibilities: (1) If the game is not repeated or there is an endgame, (2) if information for the actors or players is lacking or asymmetric, (3) if large and/or heterogeneous groups form. In any case, individual actors make decisions based on complex institutions; and in some cases individual decision making leads to path dependency. If individuals lack a specific incentive-structure, the institutions that confine the role of the individuals do not change. In turn, individuals and institutions are quite static. In this way, individual incentives are extremely important to both the actions of individuals and the institutions of society.

Reversal of Fortune due to Institutions

David Acemoglu finds that individual incentives are key in the profit of certain regions of the world. Due to the institutional divisions of the world, certain similar geographies appear to be entirely different in their economic success. Acemoglu discovers that even though geography, climate, and ecology are important, institutions are fundamental catalysts to change. Furthermore, elites are able to change institutions, although elites only appear to change institutions based on their personal perceived benefit from the change; this occurs even if the greater good suffers. David Acemoglu coins the term “Reversal of Fortune” and recognizes that over the past 500 years societies have dramatic changes based on the individual incentive of elites.

Institutional Implications

Clearly, individuals react to their environment in predictable manners, at least in part, due to the institution that confines the behavior of the individual. Smith argues individuals specialize and trade to meet their needs; and their incentive forms from acquiring the level of tradable assets needed for exchange. Whereas Ricardo describes the implications of individuals as dependent on the institutional context; the role of the individual is determinate on the comparative advantages of states. Additionally, Ricardo focuses on the concept of states changing their trading capacity based on international economic institutions and exchange. Crook finds that losses from cheaper imports is at least possible in theory; in the event that increased exchange increases production, the prices of goods and services decreases, and individual incentives change based on changing market forces. North notes that individuals without incentive do not change their behavior, and that the resulting institutions, which limit the role of the individuals, do not morph into different institutions. Acemoglu acknowledges that institutions do not change with overall societal benefit, but rather to the incentive of individuals with power; and, fortune can reverse in cases where a small selfish elite controls the institutions. Although every case mentioned by these authors is different, institutions are important to individual incentive.