Economics of Institutions
PhD course, Norwegian School of Economics
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Introduction

The objective is to set forth a coherent conceptual framework for the analysis of institutions (social rules) ranging from laws and norms to the rules that govern behavior in organizations. The game theoretic framework integrates the methodological individualism of economics with central group-level concepts of sociology, thereby formalizing, unifying, and extending hitherto informal and fragmented bodies of knowledge.

The intended learning outcome is that students will be able to apply (behavioral) game theory to analyze the causes and consequences of important social institutions.

The course is not intended to be “representative” of all of institutional economics. Instead it focuses on some core areas where I have something relevant to say.

Reading

There exists no good textbook that covers the whole range of issues discussed in the course. Lecture notes are therefore important. Lecture notes will be available on It’s Learning 24 hours before each lecture. Required reading consists primarily of a collection of academic articles.

In the reading lists below, the required reading is marked (*) whereas optional reading is marked (o).

Administration

The course secretary is Dagny Kristiansen. Lecture notes and other course materials will be made available to all registered students on It’s Learning.
Examination

The examination consists of a term paper, written either individually or (preferably) in pairs. On 29 August, there is a one-day seminar, in which students get to present and discuss their term papers.

Course Overview

Below are the main themes we will cover and some pointers to the literature. Again please note that this is only a rough guide. There may be changes along the way.

Introduction and Background

To fathom the potentially large influence of institutions on human welfare, students are encouraged to browse some overview articles, such as North (1991) and Olson (1996). To get a sense of the current state of the art, they might look at Acemoglu, Gallego, and Robinson (2014). It is useful to do this before the course starts. Below, I also list some other relevant background articles. I’ll only cover this material in a cursory fashion.

The course will use game theory extensively. Basic concepts are introduced at the start of the course, but students whose knowledge of game theory is very limited or rusty will benefit from reading up on beforehand. At a minimum, students need to be familiar with the Nash equilibrium concept.


Social Conflict, Social Preferences, and Social Norms

To what extent do people really have conflicting interests? To what extent do social preferences and social norms help us cooperate? In my view, internalized social norms is an important explanation of cooperative behavior, but theory is lagging behind the evidence. Read Krupka and Weber (2013) and skim Ellingsen et al (2012), the rudimentary note by Ellingsen and Mohlin (2014), and Sobel (2005).


Anarchy and Situational Change

In an anarchy, might is right and promises are worthless. Game theory offers a deep understanding of why people may fail to cooperate; skim Skaperdas (1992). But what does it mean to implement better institutions? How can it be done - in principle? Here, game theorists have done a poor job. As a result, there is still a big debate about how to even define institutions; see Greif and Kingston (2011). The literature on social capital is even more conceptually confused; see Sobel (2002). We must begin to do better; see lecture notes.

We first discuss how people may enforce their own agreements through “relational contracts” involving rewards as well as punishment. We also discuss the emergence of third-party enforcement of contracts. Finally, we note how relational contracts may also be detrimental; government sometimes does more harm than good.


**Coordination, Authority, and Institutional Change**

Generally speaking, economists have emphasized incentive problems while neglecting coordination problems. Perhaps this is exactly wrong. Authority is a particularly important coordination device. Giving authority to managers – or to politicians and judges – helps solve coordination problems. However, authority also creates a commitment problem for the person in charge. How to constrain managers and other rulers?
Limits to Negotiation

Suppose there are strong institutions that protect property rights and enforce contracts. Does this mean that people will agree to behave efficiently? The answer is no, for two different reasons. First, there is an incentive to negotiate strategically, and without competition there may then be impasse in the most plausible equilibrium. Second, there is an incentive to free ride on the agreements of others. In either case, it may be better to rely on other decision-making procedures.
