

Institutions I

MPA 612: Public Management Economics

March 5, 2018

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Current events

Plan for today

Institutions

Rules, power, allocations, and fairness

The rules of the game

Institutions run the world

Institutions

Laws

Rules

Regulations

Customs

Norms

Moral injunctions

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

BUUUUUUUUT

The whole Smithean premise falls apart in the absence of constraints

No property rights?

No right to transfer property?

No liability for contract breaches?

So what are 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; etiquette, customs, conventions

**Are formal or informal
institutions more powerful?**

**There's no clear divide
between formality and
informality**

Informal LDS institutions

White shirts

First M. Last

President EQ vs. Sister RS

Sacrament handedness

1st counselor position on stand

Easter vs. Christmas

Why do people follow some rules, ignore other rules?

**Institutions =
temporary equilibria**

Rules meet game theory



Institutions are outcomes of games

Decisions based
on payoffs,
repetition, etc.

Self-enforcing

Self-reinforcing

Self-undermining

Self-enforcing

Stable, Nash equilibrium

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

Self-enforcing

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

Equilibrium increasingly stable

Institution entrenches itself

Codified road signs

More right-sided cars

Too hard and costly to change

Self-undermining

Equilibrium deteriorates

Tourists from other-sided countries
hate coming

Tourism industry suffers

People agitate for change
(while still driving on original side)

Self-enforcing

Self-reinforcing

Self-undermining



Coca-Cola

Summary of institutions

Rational choice ignores external factors

Institutions-as-rules doesn't explain changes or uneven enforcement

Institutions-as-equilibria saves the day

Rules, power, allocations, and fairness

Institutions again run the world

Power

The ability to do what we want in opposition to the intentions of others

Who gets to decide what?

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

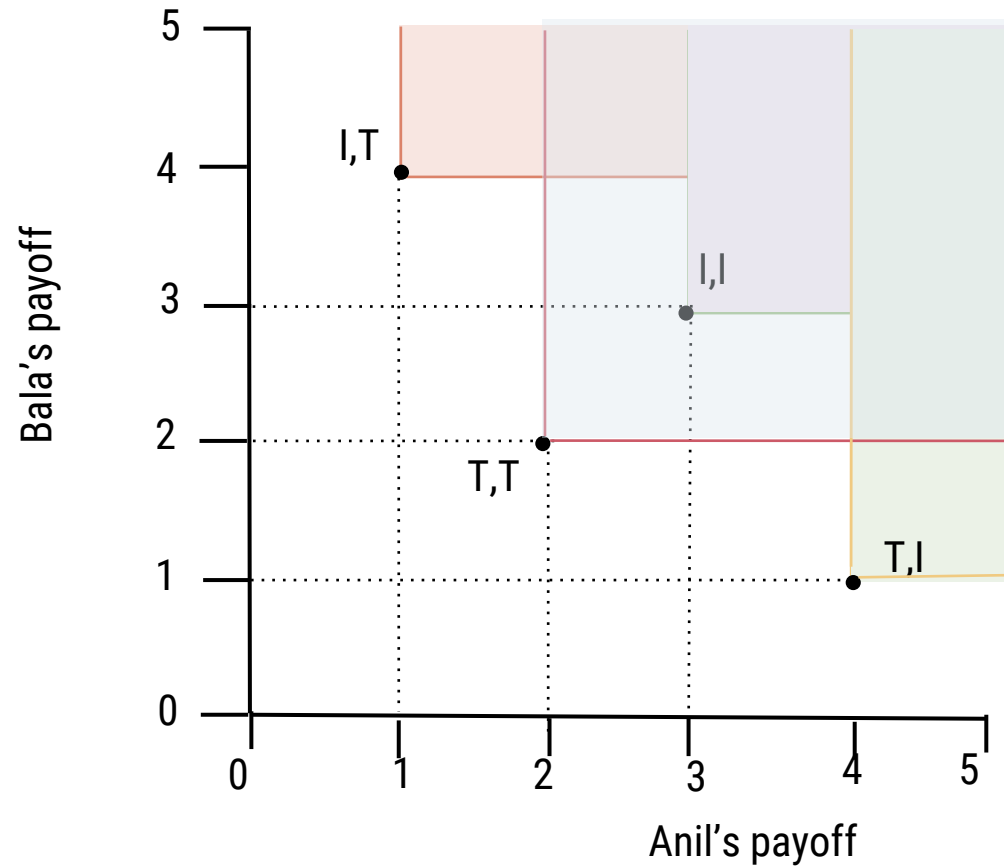
**How do we evaluate
allocations?**

Pareto efficiency

No alternative allocation where one person would be better off and nobody would be worse off

Better off $\neq$ more money

Outcome is preferred because of norms, culture, money, other institutions



- Outcomes better for both than I,T
 - Outcomes better for both than T,I
 - Outcomes better for both than I,I
 - Outcomes better for both than T,T
- I,I = Both use Integrated Pest Control (IPC)
I,T = Anil uses IPC, Bala uses Terminator
T,I = Anil uses Terminator, Bala uses IPC
T,T = Both use Terminator

BUUUUUT

More than one Pareto-efficient allocation

Pareto efficient $\neq$ better

No rankings

No fairness

**Let's create
economic policy!**

Annual income	Tax rate
\$0–\$10,000	0%
\$10,001–\$50,000	10%
\$50,001–\$100,000	20%
\$100,001–\$300,000	30%
\$300,000–\$∞	50%

1: Progressive tax rate

Increasing marginal rates

2: Flat tax

15% regardless of income

$$\$80,000 \times 15\% = \$12,000$$

Jody earns \$80,000 a year.

She pays 0% on first \$10,000

$$\$10,000 \times 0\% = \$0$$

She pays 10% on the next \$40,000

$$\$40,000 \times 10\% = \$4,000$$

She pays 20% on the last \$30,000

$$\$30,000 \times 20\% = \$6,000$$

Total tax:

$$\$0 + \$4,000 + \$6,000 = \$10,000$$

Next time

More institutions

Trade, tariffs, and fairness

