

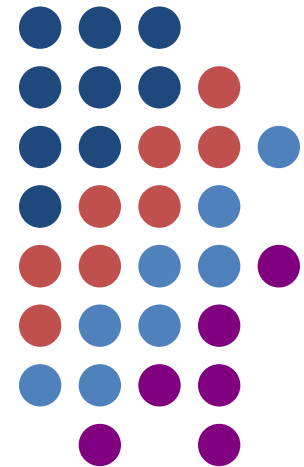
# Class 9: Institutions

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Introduction to Public Policy

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November 2015



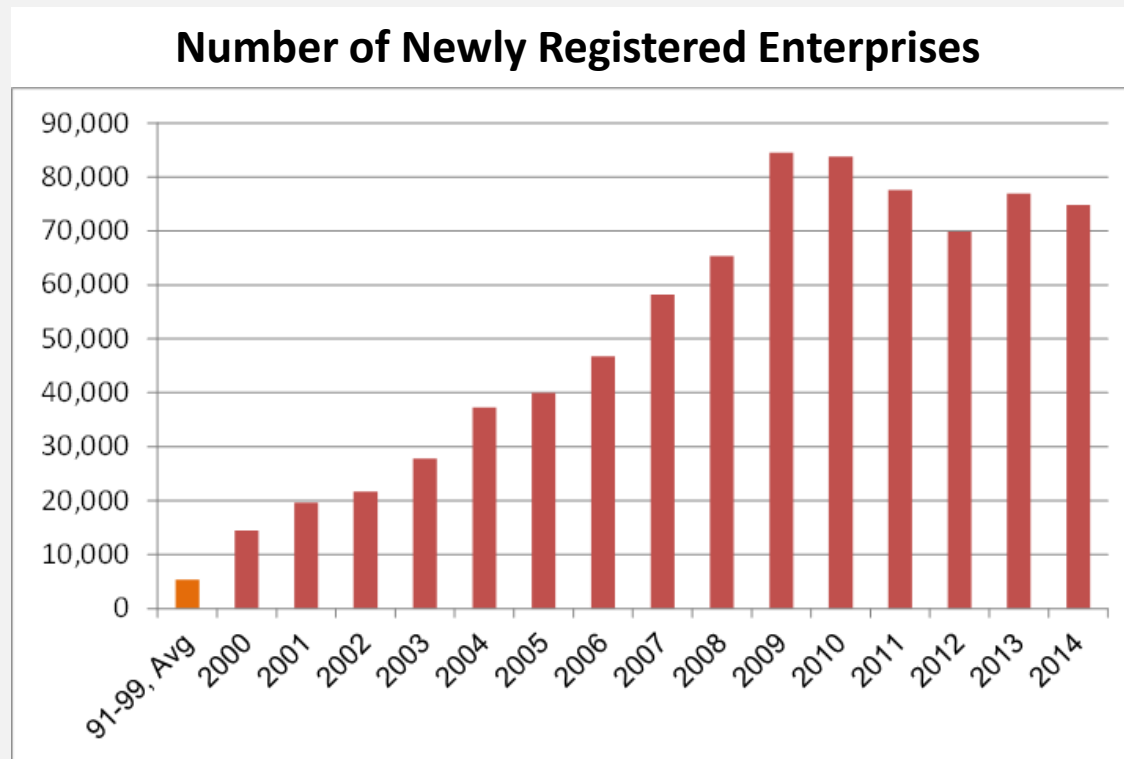
# What Are Institutions?

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- Douglass North (1990): Institutions are humanly devised norms or rules that adjust and structure to put constraints on social, political, and economic interaction.
- Institutions include:
  - Rules
    - Formal rules (laws), or
    - Informal constraints, norms, codes of conduct
  - Enforcement mechanisms
    - Internal enforcement mechanism, or
    - External enforcement mechanism
- Examples:
  - The Enterprise Law 1999
  - Financial institutions
  - Cooperation contract between seafood farmers and processing companies
  - Wedding invitation, party and gift giving

# VN Enterprise Law 1999

- Formally institutionalize the right to start a business and simplify procedures to set up an enterprise.
- Establish the Law Implementation Working Group.

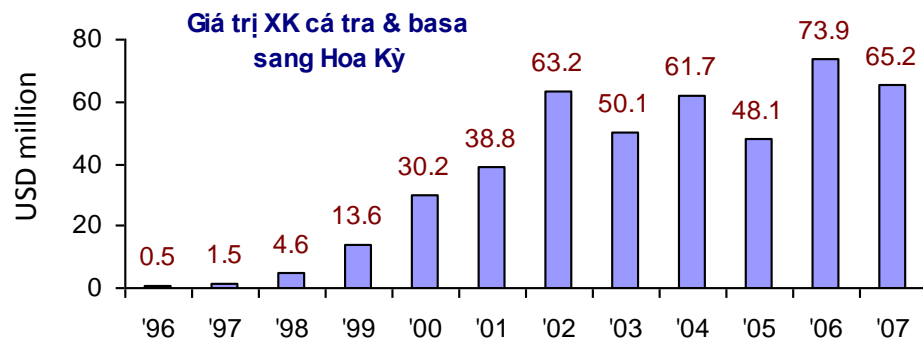


*Source:* Ministry of Planning and Investment.

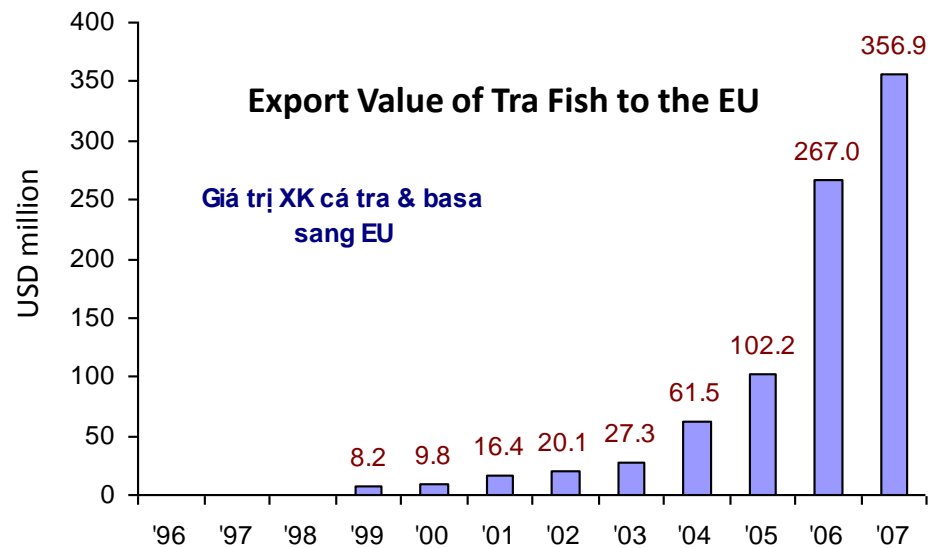
# Cooperation between farmers and companies in tra fish farming and processing

- Tra fish raised by farmers. Fish processed into frozen fillets by processing companies.
- Farmers and companies enter into contracts to buy and sell live fish.
- Contracts are enforced based on other transactions:
  - Land lease
  - Supply of materials (fingerlings, feeds, drugs,...)
  - Credit

Export Value of Tra Fish to the US



Export Value of Tra Fish to the EU



# Institutions and Transaction Costs

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- Coase Theorem:
  - With zero transaction cost and clearly defined property rights (regardless of who the property rights belong to), markets automatically generate efficient outcomes and all gains from trade are realized.
- In the real world:
  - Transaction costs exist
  - Transactions costs may be significant
- Institutions:
  - Can help reduce transactions costs
- Market-supporting institutions
  - Foster market development and make markets function efficiently

# Why Do We Need Market-Supporting Institutions?

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- Market failures
  - Monopoly
  - Information Asymmetry
  - Externality
  - Public good
- Ronald Coase: If there were no transaction costs, the above failures would correct themselves.
- When transaction costs exist, market failures may lead to:
  - Absence of market (1)
  - Inefficient market and inefficient allocation of resources (2)
  - Government may intervene, but suffers from government failures (3)
- Effective market-supporting institutions help solve the above problems.

# What Do Market-Supporting Institutions Do?

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- Increasing competition in markets—or decreasing it
- Channeling information about market conditions, goods, and participants.
- Defining and enforce property rights and contracts, determining who gets what and when.

# Do all institutions promote efficient and inclusive markets?

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- Institutional designs that evolve through historical circumstances or are directed by policymakers are not necessarily the best for all of society.
- Institutions that once supported market transactions can outlive their usefulness.
- The challenge for policymakers is to shape institutional development in ways that enhance economic development.



# Is there a unique effective institutional structure?

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- The impact of a particular institution depend on:
  - Availability and cost of supporting institutions;
  - Degree of transparency;
  - Underlying human capacity; and
  - Technology.
- Institutions that achieve their goals in some countries may not do so in others.

# Extractive Institutions

*Acemoglu & Robinson (2012)*

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- **Extractive political institutions:** The political institutions concentrate power in the hands of a few individuals or groups without restriction, checks and balances, there is no "rule of law".
- **Extractive economic institutions:** There is no law and order, property rights are not guaranteed, market entry barriers and regulations hinder the operation of the market and create an unfair playing field.

# Inclusive Institutions

*Acemoglu & Robinson (2012)*

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- **Inclusive political institutions:** The political institutions allow for broad participation; impose restrictions and control on politicians, the rule of law (closely related to the broad participation). But there is also a sufficient concentration of political power to be able to effectively enforce laws and maintain order.
- **Inclusive economic institutions:** Property rights are guaranteed, law and order, relying on the market, the state supports the market (via public services and regulations); market entry relatively free, respect for contracts, access to education and opportunities for the majority of citizens.

# Why Nations Fail — or Succeed?

## Acemoglu and Robinson Paradigm

Extractive Economic and  
Political Institutions

Inclusive Economic and  
Political Institutions

*Vicious Circle*

- Narrow elite groups
- Unchecked authoritarianism
- (Arbitrary) Rule by law/person
- Predatory state
- Crony capitalism/monopoly
- State-controlled society
- State-driven inequality
- Political and economic power merger

*Iron Law of Oligarchy*

*Critical Junctures*

*Virtuous Circle*

- Broad coalitions
- Checks and balances
- Rule of law
- Developmental state
- Market capitalism/competition
- Empowered civil society
- State mitigates inequality
- Health, education and safety nets

*Creative Destruction*

*Historical Contingency*

*The persistence and strengthening of absolutism  
have impoverished North Korea and Myanmar*

*Pluralism transcends authoritarian growth,  
creating modern South Korea and Taiwan*