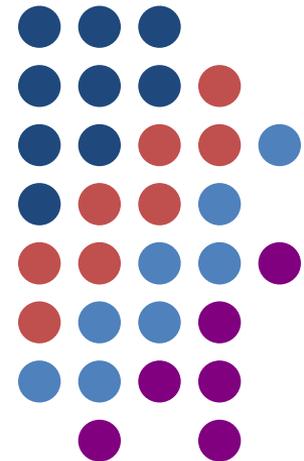


Class 9: Institutions

Introduction to Public Policy

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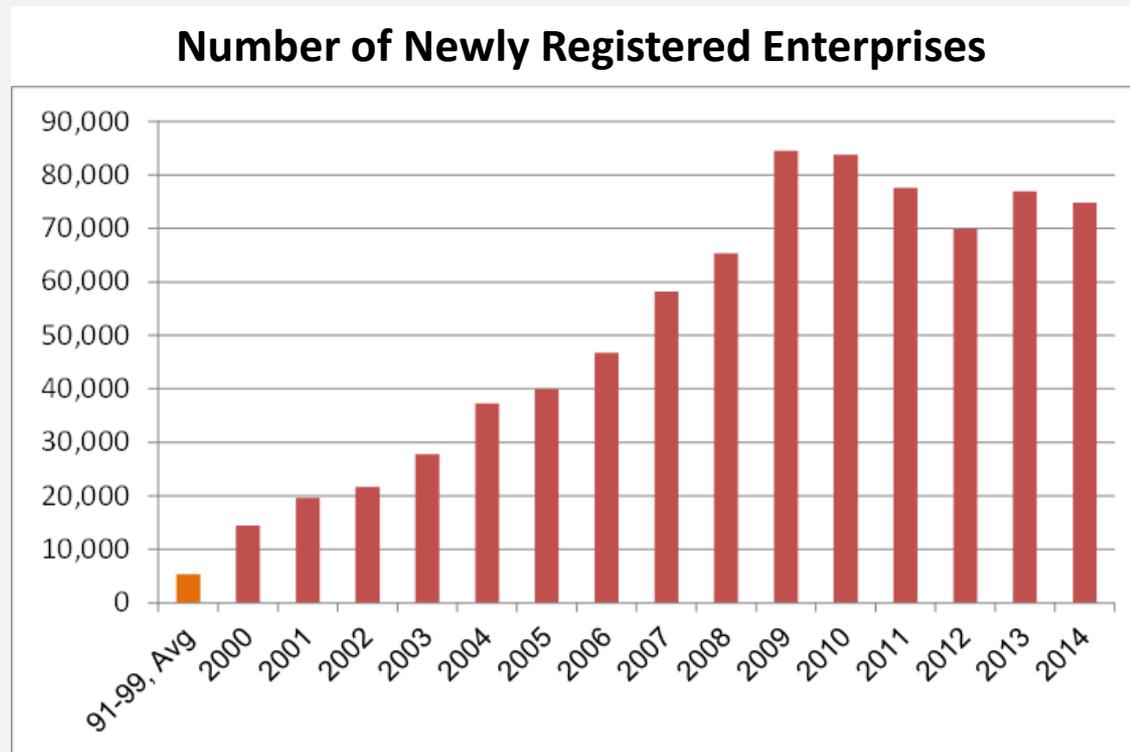


What Are Institutions?

- 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.

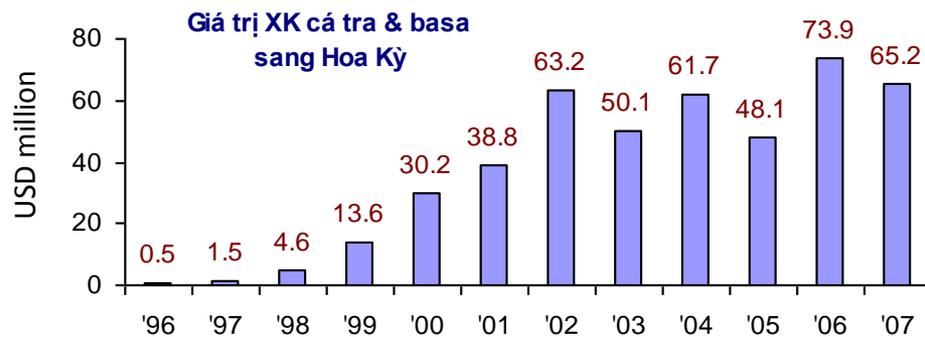


Source: Ministry of Planning and Investment.

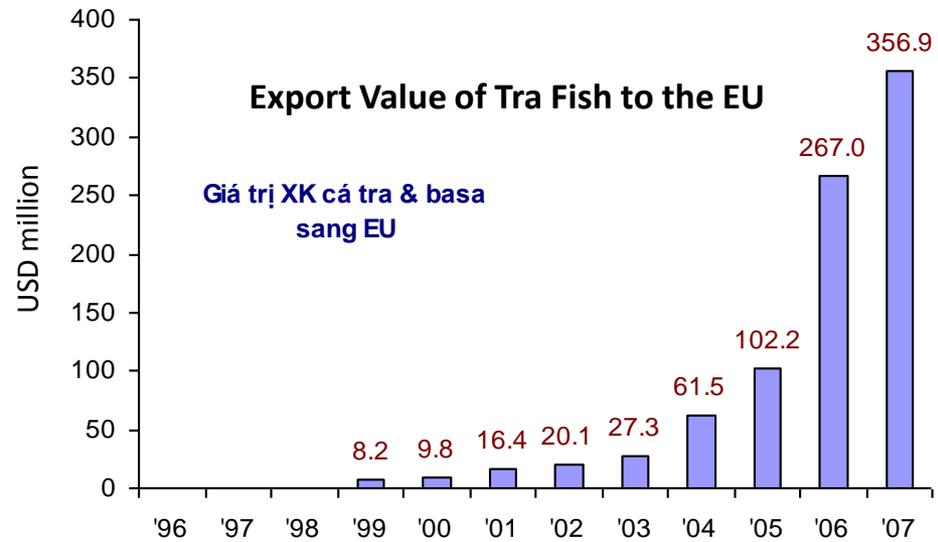
Cooperation between farmers and companies in tra fish farming and processing

- 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



Source: USITC & Eurostat.

Institutions and Transaction Costs

- 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?

- 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?

- 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?

- 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?

- 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)

- **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)

- **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*