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Programme 'HSE and University of London Double
Degree Programme in Economics'
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INSTITUTIONAL ECONOMICS

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Abstract

The elective course in "Institutional Economics" is taught to the fourth year undergraduate students and is designed to last one semester. The course is delivered in the form of lectures and seminars.

A course in "Institutional economics" accomplishes a series of courses that constitute the basic training for economists. In this course students study the impact of institutions on the incentives of economic agents, and eventually on the wealth of society. The course also gives an economic explanation to institutions of the economy. Neoinstitutional economic theory states that institutions have efficiency implications for resource allocation and for the welfare of all members of the society under the assumption of positive transaction costs. Institutional structure of the economy determines the incentives of the participants of economic activity, their possibilities range and the transaction costs they bear.

The course in institutional economics introduces the main concepts that describe the institutional structure of the society and help to understand that institutions matter both in theory and in practice.

Prerequisites

Before studying institutional economics students should master not only the fundamentals of general economic theory but have knowledge of historical courses and humanities as well. Students are supposed to be competent in basic economic analysis up to the level of the Introductory Microeconomics and Microeconomics-2 and be familiar with the basics of the game theory.

Learning Objectives and Outcomes

⇒ to provide an overview of recent developments in the field of institutional economics

⇒ to introduce the basic concepts and techniques related to the subject

⇒ to show the students how the institutional structure of the economy determines the incentives of economic agents

⇒ to help the students to understand the role of institutional environment in economic theory and in business practice

The student should be able to apply professional knowledge and skills acquired while studying the course in practical areas, including academic research, work in financial institutions, industry, state governance.

Methods of Instruction

Lectures
Classes
Consultations
Self-study

Grading System and Knowledge Assessment

The following forms of control are used to determine the final grade:

⇒ written home assignments (5);

⇒ test (80 min),

⇒ written exam (120 min) at the end of the fall semester

Formula of the final grade:

$G_{final} = k_1 * G_1 + k_2 * G_2 + k_3 * G_3 + k_4 * G_4$, where

G_1 is the average grade for home assignments, $k_1 = 0,1$
G_2 is the test grade, $k_2 = 0,2$
G_3 is the grade for presentations, $k_3 = 0,3$
G_4 is the grade for the written exam, $k_4 = 0,4$

Sample materials for knowledge assessment are available in ICEF Information system at https://icef-info.hse.ru.

Required Reading

1.Odintsova M.I. Institutional economics. Textbook. Moscow: Urait, 2014 (rus.)

Optional Reading:

Books

1. Hart O. Firms, Contracts and Financial Structure. Oxford, Clarendon Press, 1995.
2. Milgrom P., Roberts J. Economics, Organization and Management. – Prentice-Hall Int., 1992.

Internet resources

Society for Institutional & Organizational Economics https://www.sioe.org

Libertarium Library http://www.libertarium.ru/library

Special Equipment and Software Support

Laptop, projector, Internet connection
MS Word, MS Excel

Course plan

1.Introduction to institutional economics

The concept of an institution: attempts at definition. Institutions and organizations. Functions of social institutions.

Interaction situations and the types of norms: prisoners' dilemma-type situation; co-ordination situation; inequality situation. Enforcement characteristics.

Institutional structure of the society. Formal and informal institutions. Sanctions for disobeying norms (self-enforcing sanctions, guilt, shame, informational sanctions, bilateral costly sanctions, multilateral costly sanctions). Conditions of norms' effectiveness.

Interaction of formal and informal institutions. The limits of imitations of institutions from best-performing countries. The problems of their enforceability.

The new institutional economics and modern institutionalism. Old institutionalism.

2. Transaction costs

The concept of transaction. Market and intrafirm transactions. Transaction costs as friction in the economy. Two main theoretical approaches to transaction costs.

Transaction costs and transformation costs. Interdependency between transaction costs and transformation costs.

Types of market transaction costs and means of transaction costs minimization.

Search and information costs.

Measurement costs. Seach goods, experience goods and credence goods. Excessive measurement. Productive and distributive information. Business practices as means of economizing on measurement costs (warranties, share contracts, brand name). Overseaching and suppression of information - "pig in a poke".

Bargaining costs. Cooperative surplus and different ways to divide it. Hobbes bargaining as a social dilemma. Battle of sexes, Stackelberg strategy and reputation of the leader. Credible threats. Bargaining costs and types of contracts.

Supervision and contract enforcement costs. "State of the nature", trust game and contract enforcement. Hostage, collateral, self-enforcing agreement and emotional union as private means of bilateral contract enforcement. Reputation as a contract enforcement device. Bilateral and multilateral reputation. Shortcomings of the reputation as a contract enforcement mechanism. Reputation, information and the "free rider problem".

Reputational mechanism supported by organisations. Comparative advantages and shortcomings of the legal enforcement mechanism. Contract enforcement mechanisms as second-best solutions.

Transaction costs of protection against the encroachment of third parties.

Transaction costs, the main types of economic exchange and their supporting institutional structures. Coexistence of the main types of economic exchange in the modern society.

Transaction cost measurement. Transaction costs in the Russian economy.

3. Property rights theory

The definition of property rights. Property rights in different legal traditions (common law and civil law traditions).

The property rights approach: some basic concepts. Specification of property rights, the bundle of rights, partitioning of property rights, attenuation of property rights.

Assigning property rights: the internalization of externalities. The Coase Theorem. Critic of Coase (dynamic effects of alternative legal rules, wealth effect, distributional effects, strategic behavior and the problem of holding-out, endowment effect, sociological critic, unrealistic assumption about zero transaction costs)

Alternative property rights regimes. Common property (open access) and the tragedy of the commons. Exclusive property rights and the conditions for their emergence. Trasaction costs of property rights specification. Communal property. Optimal group size. The First economic revolution. Private property. Public property.

The emergence of property rights. The optimistic theory of the emergence of property rights (naive model). The interest-group theory of property rights. The costs of collective action. The theory of rent-seeking.

4. Contracts

The definition of a contract. Legal and economic approach to contracts.

Bounded rationality and contractual incompleteness.

Asymmetric information (hidden characteristics, hidden information/ hidden action, hidden intentions) and opportunistic behavior.

Adverse selection and the closing of markets. Signalling, screening and self-selection.

Asset plasticity and moral hazard. Principal-agent problem and agency costs. Controlling and preventing moral hazard (controlling the agent, incentive contracts, bonding, do-it-yourself). Case study: crisis of the savings and loan associations in America as an example of moral hazard in financial markets.

Attributes of transactions and the choice of a contract. Asset specificity, types of specific assets. Synergy effects, quasi-rents appropriation and hold-up problem. Classification of contracts (classical, neoclassical and relational contracting). Discrete alternative governance structures: market, hybrids and hierarchy. Hybrids: specific assets and their safeguards.

Institutional environment and the role it plays in the choice of contract. The role of trust. Economic approach to trust. Types of trust (contractual trust, competence trust and goodwill trust).

Explaining the internal structure of formal organizations: transaction costs approach.

5. Institutional theories of the firm

Neoclassical theory of the firm. Explanations of the firm in the new institutional theory (F.Knight, R. Coase, Simon H., A. Alchian and H. Demsetz, O.Williamson, O.Hart).

The market and the firm. Comparative analyses of the alternative coordination forms. Internal market and influence costs. The boundaries of the firm.

Ownership structure of the firm. A theory of the owner-monitor (Alchian and Demsetz, 1972).

Competing forms of economic organization, relative advantages of alternative structures (proprietorships, partnerships, open corporation, regulated firms, public enterprises, nonprofit organizations, labor-managed firms).

Separation of ownership and control in the open corporation. Opportunistic behavior of managers and corporate control. Outsider and insider corporate control. Privatization in Russia and other transition economies and corporate governance.

6. Economic theory of the state

Social mechanisms for constraining open access. Contractual theories of the state (Locke, Rousseau), Hobbes predatory theory of the state. North's model of the state.

The regulatory role of the state in the Russian economy.

7. Institutional Change

Stability of institutions and institutional change. The concept of institutional equilibrium. The main sources of institutional change. Centralized and spontaneous institutional change. The role of the state in the process of institutional change. The problem of the compensation of disadvantaged groups.

Selection of efficient institutions in the process of competition (Alchian, Friedman). Institutional change and path dependence. Forms of path-dependence (weak form, semi-strong and strong forms).