

Syllabus

Faculty of Economic Sciences

Institutional Economics (1 Semester)

Instructor's names: Maria Yudkevich, Elena Podkolzina

Class Times and Locations

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Section 1. General information about the course

Course on Institutional Economics is a step towards understanding institutions and their role in economics and society. During this course we will show that in the world where all transactions are connected with costs and people squint towards opportunism, it is important to create rules and systematically monitor everyone is following them. Together these rules and enforcement mechanisms are called institutions.

The main objective of this course is to demonstrate how institutions work in various spheres, what happens if they become weak or inefficient. We will talk about the institution of property rights and about contracts, will look for historic examples and analyze modern cases, will find evidence of the fact that institutions are vitally important for the prosperity of countries as well as for making the simplest transactions between citizens possible.

Course on Institutional Economics gives an overview of modern institutional theory, its development and current state, its basic instruments and approaches. Special focus is made on ways to use these instruments and approaches for solving real-life problems.

Section 2. Course goals, learning objectives, expected learning outcomes

The course has the following main objectives:

- to form a detailed view about current development of new institutional theory, about main instruments and approaches,
- to develop competences, which allow to implement the methodology of new institutional economics towards solving practical problems.

When completing the course, students should be able:

- to demonstrate the knowledge of key concepts and methodology of institutional theory and to apply this knowledge to the practical cases,
- to extract ideas from theoretical literature and apply them to the real cases,
- to assess the rules and norms of governance and management from the institutional point of view,
- to analyze alternative solutions to the problems posed in terms of institutional economics.

Students should have an understanding of basic economic analysis up to the level of Introductory Microeconomics. Preliminary knowledge of quantitative research methods and econometrics is an asset, but not required.

Section 3. Course Outline

№	Topic/Focus/Activity	Week	Course format:				Readings and assignments
			lectures (L)	seminars (S)	consultations	workshops, etc. (in hours)	
1	Introduction	1	L 2				[1] - ch 1; [2] – ch 1; [3] – ch 1
2	Institutions -1	1	L 2				
3	Institutions -2	2	L 2				[1] - ch 3; [2] – ch 2; [3] – ch 2,3; [4]
4	Transaction costs (TrC)	2	L 2				
5	Institutions, TrC and Networks	3	L 2				[1] - ch 4; [2] – ch 5,6; [5]
6	Institutions	3		S 2			
7	Institutions and TrC	4		S 2			[1] - ch 4; [2] – ch 2; [3] – ch 8
8	Networks	4		S 2			
9	TrC and Incomplete contracts	5	L 2				[1] - ch 2; [2] – ch 4,5; [6]; [7]
10	Agency theory - adverse selection	5	L 2				
11	Agency theory - moral hazard	6	L 2				[1] - ch 2; [2] – ch 4,5; [8] Mini CW 1
12	TrC and Incomplete contracts	6		S 2			

13	Property rights and agency theory	7	L 2				[1] - ch 4, 5; [2] – ch 3
14	Property rights	7	L 2				
15	Agency theory - adverse selection problems	8		S 2			[2] – ch 4,5 Mini CW 2
16	Agency theory - moral hazard problems	8		S 2			
17	Institutions, Property rights, Contract	9		S 4			Presentations of literature review
18	Property rights and theories of the state	10	L 2				[1] - ch 8, 9; [2] – ch 3,7; [9] Control work - part 1
19	Institutions, TrC and Contracts	10		S 2			
20	Theories of the state	11	L 2				
21	Institutions and growth	11	L 2				[1] - ch 9, 10; [2] – ch 6,9; [3] – ch 9,10
22	Institutional Change	12	L 2				[1] - ch 9, 10; [3] 10,11
23	Public Procurement	12	L 2				Business game
24	Property rights	13		S 2			[1] - ch 4,5; [2] – ch 7,8; [10] Mini CW 3
25	Intellectual property rights	13		S 2			
26	Institutional analysis of bureaucracy	14		S 2			[2] – ch 9; [3] – ch 12; [11]; [12]
27	Institutions and growth	14		S 2			
28	Corruption and institutional traps	15		S 2			[3] – ch 13,14; [13] Homework
29	Property rights, State, Institutional Change	15		S 2			Control work - part 2

Description of course methodology and forms of assessment to be used:

- Presentations
- Research projects
- Business games
- Group work and group presentations
- Mini-control works
- Control works

Section 4. Texts, readings and other informational resources

Required readings:

1. Eggertsson T., *Economic Behavior and Institutions*, Cambridge University Press, 1990
2. Furubotn, E. G., and R. Richter. *Institutions and economic theory: The contribution of the new institutional economics*. University of Michigan Press, 2010.
3. North D.C., *Institutions, institutional change and economic performance*, Cambridge University Press, 1990
4. Brandes, L., Brechot, M., & Franck, E. (2015). Managers' external social ties at work: Blessing or curse for the firm?. *Journal of Economic Behavior & Organization*, 109: 203-216.
5. Ellison, N. B., Steinfield, C., & Lampe, C. (2007). The benefits of Facebook "friends:" Social capital and college students' use of online social network sites. *Journal of computer-mediated communication*, 12(4): 1143-1168.
6. Carmichael, F., & Thomas, D. (2000). Institutional responses to uncertainty: evidence from the transfer market. *Economic Issues Journal Articles*, 5(1): 1-20.
7. Browne, M. J. (1992). Evidence of adverse selection in the individual health insurance market. *Journal of Risk and Insurance*: 13-33.
8. Presbitero, A. F., & Rabellotti, R. (2014). Geographical distance and moral hazard in microcredit: evidence from Colombia. *Journal of International Development*, 26(1): 91-108.
9. Galiani, S., & Schargrodsky, E. (2010). Property rights for the poor: Effects of land titling. *Journal of Public Economics*, 94(9-10): 700-729.
10. Adermon, A., & Liang, C. Y. (2014). Piracy and music sales: The effects of an anti-piracy law. *Journal of Economic Behavior & Organization*, 105: 90-106.
11. Houston, D. J. (2000). Public-service motivation: A multivariate test. *Journal of public administration research and theory*, 10(4): 713-728.
12. Guiso, L., Sapienza, P., & Zingales, L. (2006). Does culture affect economic outcomes?. *Journal of Economic perspectives*, 20(2); 23-48.
13. Fisman, R., & Wei, S. J. (2009). The smuggling of art, and the art of smuggling: Uncovering the illicit trade in cultural property and antiques. *American Economic Journal: Applied Economics*, 1(3): 82-96.

Additional readings:

1. Acemoglu D., Johnson S., Robinson J. (2001) 'The Colonial Origins of Comparative Development', *American Economic Review*, 91(5): 1369-1401
2. Acemoglu D., Johnson S., Robinson J. (2002) 'Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution', *The Quarterly Journal of Economics*, 117(4): 1231-1294
3. Akerlof G. (1970) 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism', *The Quarterly Journal of Economics*, 84(3): 488-500
4. Allen F. (1985) 'On the Fixed Nature of Sharecropping Contracts', *The Economic Journal*, 95(377): 30-48
5. Banerjee A., Iyer L. (2005), 'History, Institutions and Economic Performance: The Legacy of Colonial Land Tenure Systems in India', *American Economic Review*, 95(4): 1190-1213
6. Bolton P., Dewatripont P. (2005) *Contract Theory*, Cambridge: MIT Press.
7. Coase R. (1937) 'The Nature of the Firm', *Economica*, 4(16): 386-405
8. Coase R. (1960) 'The Problem of Social Cost' *Journal of Law and Economics*, (3): 1- 44

9. De Soto H. (2000) *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, Richmond: Black Swan
10. Demsetz H. (1967) 'Toward the Theory of Property Rights', *American Economic Review*, 57: 349-359
11. Dixit A. (2010) 'Democracy, Autocracy and Bureaucracy', *Journal of Globalization and Development*, 1(1)
12. Dixit, A. (1997). Power of incentives in private versus public organizations. *The American Economic Review*, 87(2): 378-382.
13. Earle J., Estrin S. (2003) 'Privatization, Competition, and Budget Constraints: Disciplining Enterprises in Russia', *Economics of Planning*, 36: 1-22
14. Eggertsson (2013) 'Quick Guide to New Institutional Economics', *Journal of Comparative Economics*, 41(1): 1-5 • Marroquin A. (2011) 'Teaching Institutional Economics with The Fellowship of the Ring', Francisco Marroquin University, working paper
15. Ehrlich I., Lui F. (1999) 'Bureaucratic Corruption and Endogenous Economic Growth', *Journal of Political Economy*, 107(6): 270-293
16. Enikolopov R. (2012) 'Are Bureaucrats Really Paid Like Bureaucrats', New Economic School, working paper
17. Frye T. (2004) 'Credible Commitment and Property Rights: Evidence from Russia', *American Political Science Review*, 98(3): 453-466
18. Greif A., Milgrom P., Weingast B. (1994) 'Coordination, Commitment, and Enforcement: The Case of the Merchant Guild', *Journal of Political Economy*, 102(4): 745-776
19. Guriev S., Sonin K. (2009) 'Dictators and Oligarchs: A Dynamic Theory of Contested Property Rights', *Journal of Public Economics*, 93: 1-13
20. He X. (2012) 'A Tale of Two Chinese Courts: Economic Development and Contract Enforcement', *Journal of Law and Society*, 46(3): 384-409
21. Joskow P. (1987) 'Contract Duration and Relationship-Specific Investments: Empirical Evidence from Coal Markets', *American Economic Review*, 77: 168 -173
22. Ledeneva A. (1998) *Russia's Economy of Favours: Blat, Networking and Informal Exchange*, Cambridge: Cambridge University Press.
23. Moe, T. M. (1984). The new economics of organization. *American journal of political science*, 28(4): 739-777.
24. Myerson R., Satterthwaite M. (1983) 'Efficient Mechanisms for Bilateral Trading', *Journal for Economic Theory*, 29: 265-281
25. North D. (1991) 'Institutions', *Journal of Economic Perspectives*, 5(1): 97-112
26. Ostrom E. (1990) *Governing the Commons: The Evolution of Institutions for Collective Action*. Cambridge: Cambridge University Press
27. Sonin K. (2003) 'Why the Rich May Favor Poor Protection of Property Rights', *Journal of Comparative Economics*, 31(4): 715-731
28. Thaler, R. H. (2000). From homo economicus to homo sapiens. *Journal of economic perspectives*, 14(1): 133-141.
29. Tirole, J. (1994). The internal organization of government. *Oxford economic papers*, 46(1): 1-29.
30. Williamson, O. E. (1999). Public and private bureaucracies: a transaction cost economics perspectives. *The Journal of Law, Economics, and Organization*, 15(1): 306-342.

Section 5. Examination/Evaluation

This is an upper division economics course that places a heavy emphasis on the participation of students as well as critical writing assignments. Class attendance is strongly recommended, unless you are ill.

Components of cumulative mark (out of 10):

- 0,1 - homework (out of 10)
- 0,15 – presentation and essay on the paper (out of 10)
- 0,15 - mini control works (average from 3, each out of 10)
- 0,3 - research paper (out of 10)
- 0,3 - control works (average from 2 parts, each out of 10)

If the deadline is missed (for 1 day) the fine equals 20% of the mark. If the work contains citations without proper formatting (at first attempt) student is offered one more attempt at 20% reduction of the mark. In all other cases of rules violations student gets 0. There is no opportunity to rewrite mini control works or to make another presentation if the class is missed.

Example of the mini control work

The Story of a Lost Codfish¹

Paragraph 1. Natural resources conservation agencies are very concerned about the situation in fishing industry. Within the last century, codfish, tuna, plaice, and haddock stocks have decreased by 80% in the richest fishery districts of the Atlantic Ocean in the USA and Canada. Many populations disappeared completely. Today fishermen report to put 10 times more effort to catch fish in comparison to the 50^s of the XXth century. Thanks to vast sizes and new equipment, modern fishing vessels can work deep to the bottom of the ocean. However, quite often much of the catch is thrown away, and there are reasons for it: either fish does not meet demands of the market, or there is simply too much fish caught, which exceeds the quota set by local authorities. According to some estimates, about a third of the overall fish caught is thrown away back to the ocean, and most of it, of cause, is dead. Laws restricting fishing time lead to larger fishnets, and laws restricting sizes of fishnets lead to more equipped and powerful vessels. Bans on some models of vessels lead to an overall fall in effectiveness of the whole industry and harm those who invested much into it.

Paragraph 2. Let us take, for instance, fishery on the south of the Pacific Ocean, the district of big coral reefs where previously dynamite and cyanide were used for fishing, killing everything that was alive. According to the Hong Kong division of the World Wildlife Fund, currently fishery here is held “under the principle of a stable development” and “only within selected areas where rights for fishery are clearly determined”. Reefs are very valuable assets, and if someone has a right on one of them, he or she never let them be exploded. Furthermore, the owner likely sets strict regulations for fishery, hires guards to guarantee reef safety, and local community keeps a steady eye on all actions related to it. For instance, reports show that private oyster beds in Washington and other districts of the USA are in a very good environmental condition, while state oyster beds in Maryland are exhausted, and only produce 1% of their capacity.

Clearly it is harder to determine property rights for fishing industry rather than for other industries. Still, there are solutions. Some countries introduced individual quotas of catch, which can be passed from one fisherman to another. A fisherman owning such a quota has a right to catch only a certain amount of fish set by scientists and organizations responsible for conservation of resources. It is worth noticing that time and place of fishing is not restricted. Being forced to work according to this system, fishermen find

¹ <http://www.kommersant.ru/doc/719162>

themselves interested in supporting of healthy quantities of fish in populations simply because with their growth, there is a right to catch more.

Questions

1. Describe the regime of property rights on fishing resources described in the 1st paragraph.
2. What problems can occur in systems of this regime? Why?
3. In your opinion, is it possible to solve the described problems by introducing proper property rights on fishing resources? Support your answer with argumentation.

Example of the homework

Problem №1 Monitoring costs

“Happy drinks” company produces beverages with so exotic flavors that sales depend directly on the efficiency of a PR-manager. Working hard (controlling employees, answering their questions and supporting their ideas) the PR-manager makes high efforts that equal e in monetary terms. If the PR-manager works hard, “Happy drinks” company gets a revenue equal to Y . If the PR-manager does not work at all, employees spend all their working hours in social networks, and a revenue decreases to y ($y < Y$). To prevent the latter situation, the owner of “Happy drinks” may check the work of the PR-manager at monitoring cost m .

The PR-manager earns a fixed wage w in all situations, except one. If the owner monitors actions of the PR-manager and find out that he does not work, the PR-manager is dismissed without payment (0).

Task:

1. Write down a pay-off matrix for this game.
2. Find how parameters (Y , y , w , e , m) should be related when a Nash equilibrium in pure strategies does not exist.
3. Let us assume that starting today the PR-manager works not in the central office, but in the regional branch. Hence, the owner must incur higher monitoring costs: he should fly by plane instead of simply using the car. How does it influence the equilibrium? Why?

Problem №2

Adverse selection

There is only one fitness club in Leninsk town, where students can work as instructors. A student's utility function is $U_i = 2\sqrt{w_i} - \theta_i e_i$, where w_i is the wage, e_i is the level of effort, i is ID of student. It is known that one half of students has $\theta_1 = 1$ (first type) and the other half has $\theta_2 = 4$ (second type). The more efforts a student invests into trainings, the better customer feedback he gets and the more money on additional options they spend in the fitness club. The fitness-club's profit is $\pi = 8e - w$.

Task:

1. Give an economic interpretation to a parameter θ .
2. Find contracts $\{e, w\}$ offered by the fitness club to students of different types if information is symmetric. Find the fitness club's profit.
3. Let us assume that information is asymmetric (the fitness club cannot distinguish between different types of students at first glance). Write down the problem that the fitness club is trying to solve by offering contracts. Give an economic interpretation of conditions.

Example of the control work

RULES

1. The duration of the control work is 1 hour 20 minutes.

2. During the control work a student cannot leave the classroom.
3. During the control work all conversations are prohibited.
4. One cannot bring at the control work or use any materials in written or printed form.
5. One cannot bring at the control work or use any electronic devices, including smart watches, mobile phones, tablets and headphones (even turned off).
6. In case of violation p. 3, total mark is decreased by 1 point.
7. In case of violation p. 4 or 5, e.g. if a lecturer noticed a cheat sheet, a mobile phone (even turned off) or any other electronic device near a student, this student receives 0 for the control work.
8. Answer without explanations is not complete.

Task	1	2	3	TOTAL
Maximum	4	3	3	10
Mark				

TASK 1.

Varys, called "the Spider", is the master of whisperer in Westeros, who recruits new candidates for spy positions (a.k.a. "little birds"). A little bird i gets utility equal to $U_i = \sqrt{w_i} - \theta_i \cdot e_i$, where w is the wage, e efforts that she or he puts for espionage. One half of little birds are good spies, so their $\theta = 1$, the other half have $\theta = 2$. The more efforts a little bird makes, the more useful information she or he gives to Varys. Then Varys's profit equals $\pi = 12e - w$. If a little bird does not accept the contract, she or he has zero alternative utility.

Questions:

1. Give an economic interpretation for parameter θ . [1]
2. Find contracts $\{w; e\}$, which Varys offers to little birds of different types in case of symmetric information. Calculate his profit. [2]
3. Let us assume that information is asymmetrically distributed. Will little birds hide their type and pretend to be little birds of another type? Explain your answer graphically or analytically. [1]

TASK 2

Hundreds of workers stage sit-in at Annensky copper-silver mine in Kazakhstan²

On Saturday, May 5th, subterranean shift of workers of the Annensky mine – 98 people – refused to get back to the surface. The protestors said they staged this sit-in for an indefinite period of time because they were tired to work for almost nothing. Within only a couple of hours two more mines – Eastern and Southern – joined them. As a result, approximately 250 miners stayed under the ground, and the number of on-surface protestors reached 350, as reported by Interfax-Kazakhstan with a reference to Kazakhmys. At noon on the Annensky mine territory there was held a meeting between workers and Kazakhmys executives. Five workers went to the ground to take part in it and announce their demands, after which returned back to the mine. All of the 250 miners protesting under the ground refused to get back unless their wages are doubled.

Strikebreaking and ways to fight it. The 1907 experience³

There is a very curious story about one strikebreaker in a journal of a Union of Gold, Silver and Bronze Workers from February–March 1907. At those days strikes roared on factories all over the country,

² http://rus.azattyq.org/content/kazakhmys_zabastovka_strike/24571609.html

³ http://www.solidarnost.org/thems/profsoyuznyj-arhiv/profsoyuznyj-arhiv_2760.html

workers tried to fight their way to better working conditions, bigger wages, reduction of working hours, etc. However, there always were people who decided to work despite protests, thus undermining the whole action. They were called strikebreakers. Traitors were usually given silent treatment, their work was boycotted. The case described in a journal was the case of Vasilyev's manufactory. Under the decree of the Union of Gold, Silver and Bronze Workers, names of strikebreakers who "substituted for their protesting peers" were published in the journal. Among others, there was a name of Ivan I. Burmistrov who wrote a plea to the Union and his former co-workers:

"Dear comrades and Union members,

I ask you to forgive me and to stop the boycott for my work that started because I broke the strike at Vasilyev's manufactory. Although this was an imprudent deed of mine, I did not mean to support Vasilyev or worsen situation of fellow workers. Many, many things he promised. <...> Ready to serve, Ivan I. Burmistrov".

Questions:

1. What kind of transaction costs (according to the North-Eggertsson classification) can an employer meet after signing a labor agreement? Give examples of these costs on the basis of the given situation. Provide sufficient argumentation. [1]
2. How can the costs you described be lowered? Provide sufficient argumentation. [1]
3. Describe a problem of cooperation emerging from the contact of two groups of workers making a decision on a participation in a strike:
 - a. Write down a payoff matrix, describe players and their strategies, find all of the possible Nash equilibria. [1]
 - b. What is an essence of a problem of cooperation in the described case? [1]

TASK 3.

Leif Brandes, Marc Brechtob and Egon Franckb examine how social ties affect company's success in the article "Managers' external social ties at work: Blessing or curse for the firm?".

Questions:

- (1) Why do authors think that the data of the National Basketball Association are suitable for the purpose of the study? How do they estimate social ties of managers? [1]
- (2) Which is the main hypothesis of the study? What are alternative ones? On which theories these hypotheses are based? [1]
- (3) What are the main results? How does the behavior of the owner affect a team's success? Provide sufficient argumentation [1]

Section 6. Academic Integrity

The Higher School of Economics strictly adheres to the principle of academic integrity and honesty. Accordingly, in this course there will be a zero-tolerance policy toward academic dishonesty. This includes, but is not limited to, cheating, plagiarism (including failure to properly cite sources), fabricating citations or information, tampering with other students' work, and presenting a part of or the entirety of another person's work as your own. HSE uses an automated plagiarism-detection system to ensure the originality of students' work. Students who violate university rules on academic honesty will face disciplinary consequences, which, depending on the severity of the offense, may include having points deducted on a specific assignment, receiving a failing grade for the course, being expelled from the university, or other measures specified in HSE's [Internal Regulations](#).