#### INSTITUTIONS AND INSTITUTIONAL DESIGN Erling Berge

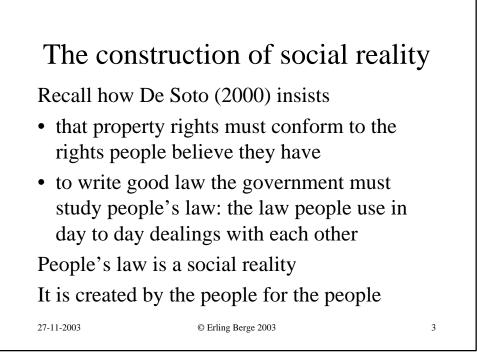
#### **Part XIV:** A kind of summary

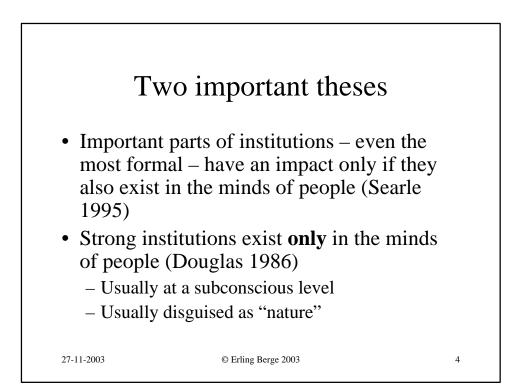
## NTNU, Trondheim Fall 2003

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•Douglas, Mary 1987 "How Institutions Think", London, Routledge and Kegan Paul •Goodin, Robert E (ed.) 1996 "The Theory of Institutional Design", Cambridge, Cambridge University Press, ch 1 •Hanna, Susan; Carl Folke, and Karl-Göran Mäler (eds.) 1996 "Rights to Nature", Washington, Island Press, ch 7 and 9 •Landa, Manuel de 1997 "A Thousand Years of Non-Linear History", New York, Swerve/ MIT Press, •North, Douglass C. 1990 "Institutions, Institutional Change and Economic Performance", Cambridge, Cambridge University Press, •Ostrom, Elinor 1990 "Governing the Commons. The Evolution of Institutions for Collective Action", Cambridge, Cambridge University Press, •Peters, B Guy.1999 Institutional Theory in Political Science, London, Continuum •Searle, John R. 1995 "The Construction of Social Reality", New York, The Free press, ch 1-6 •Soto, Hernando de 2000 "The Mystery of Capital", New York, Basic Books, •Williamson, Oliver E. 1996 "The Mechanisms of Governance", New York, Oxford University Press, ch 3



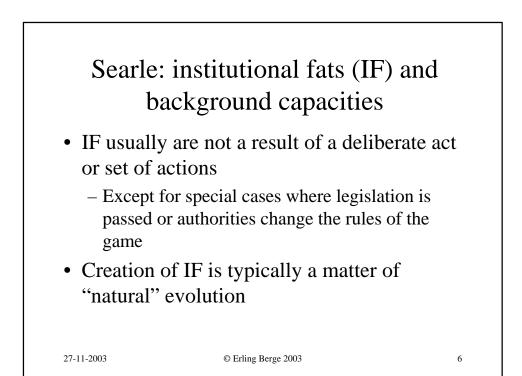


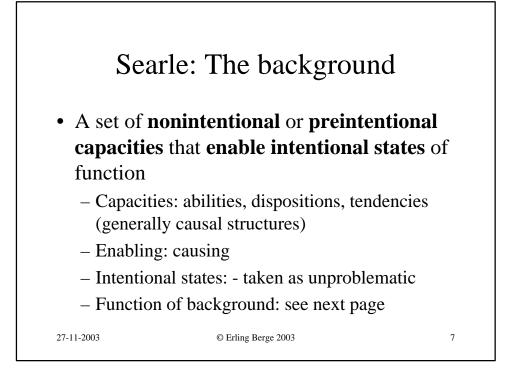
### Main points of Searle

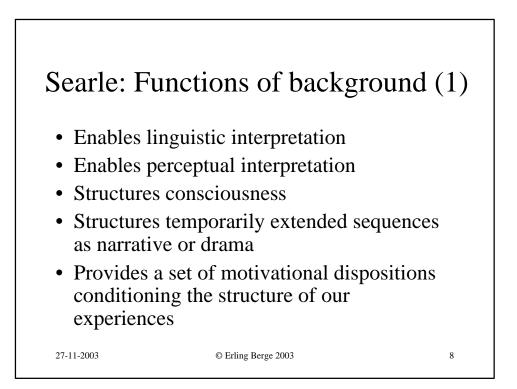
- Institutions are social facts
- They exist if and only if the relevant group of people agree that they exist
- Formal institutions are founded on "background capabilities"
- Background capabilities can be seen as a system of informal institutions, or more general, as culture

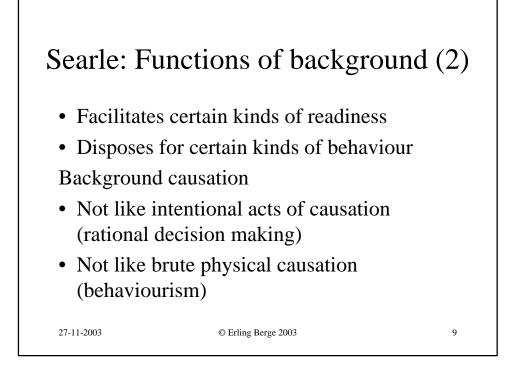
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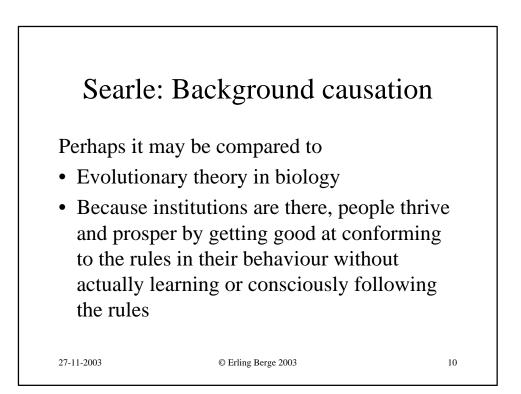
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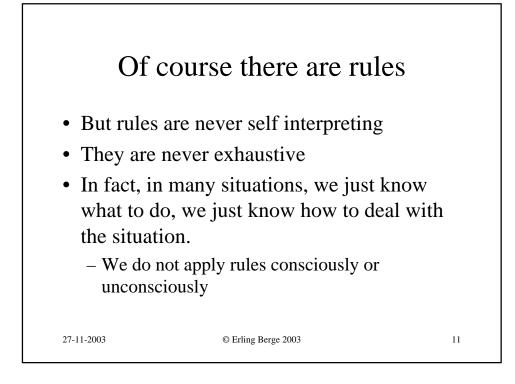


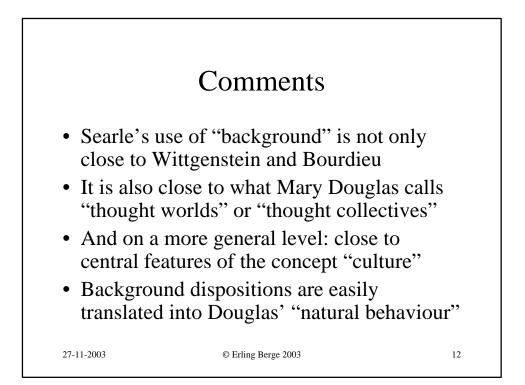


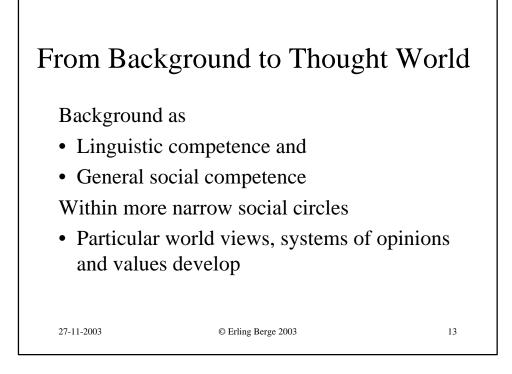


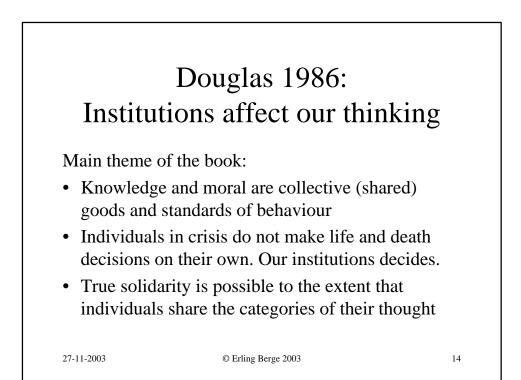




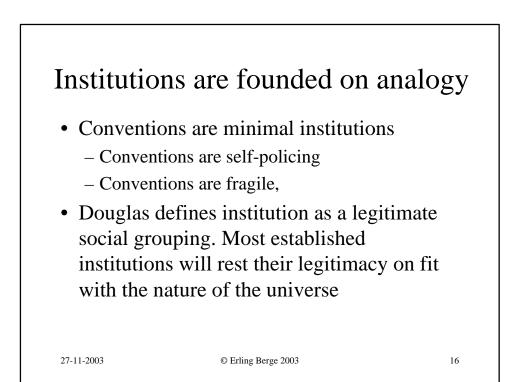


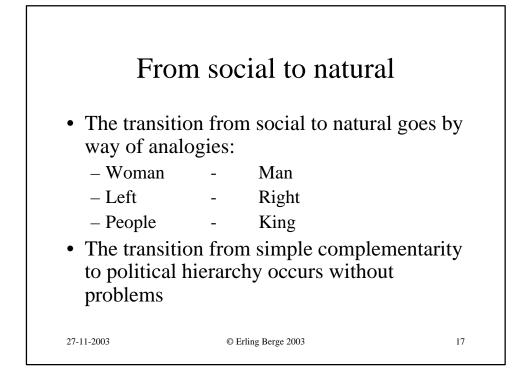


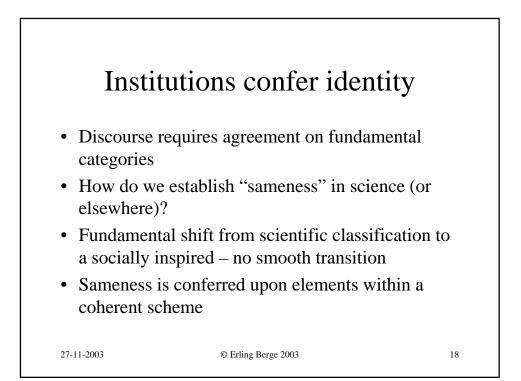


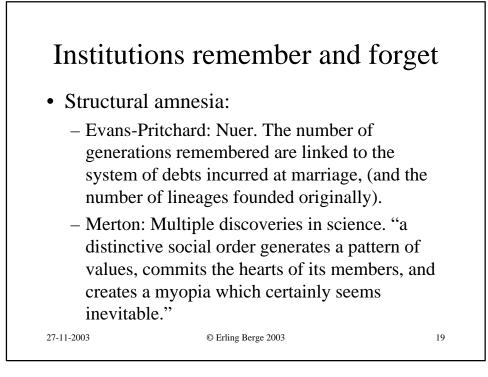


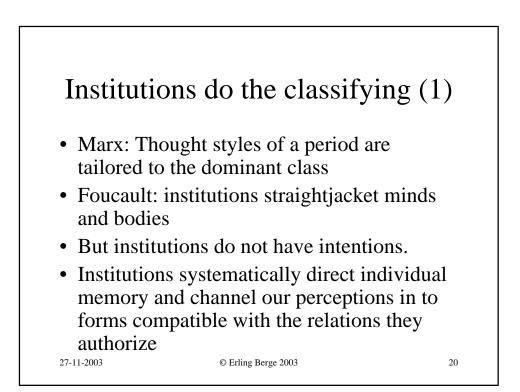


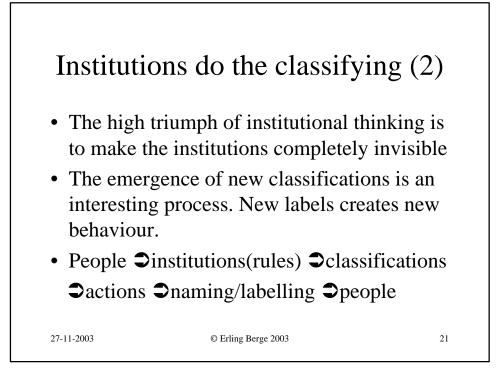


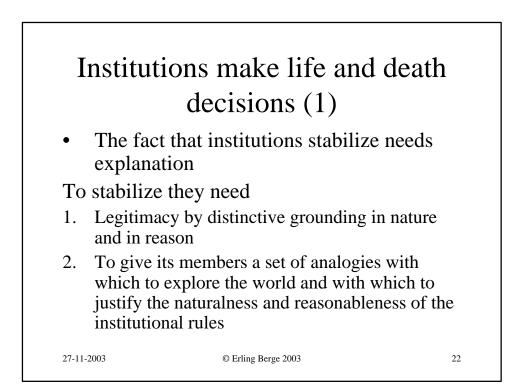


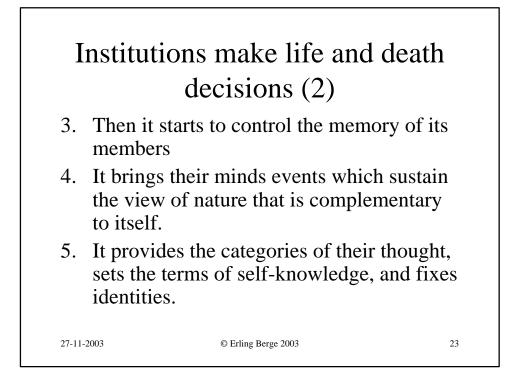


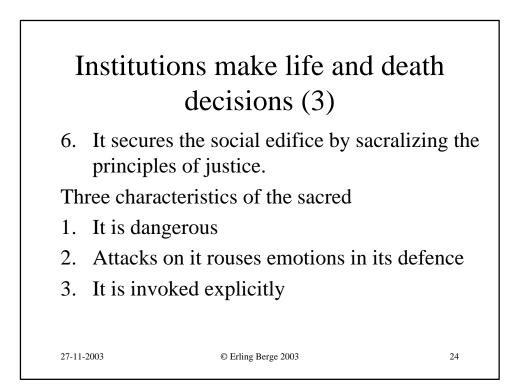


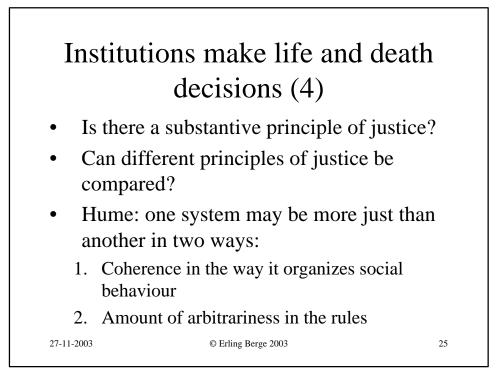


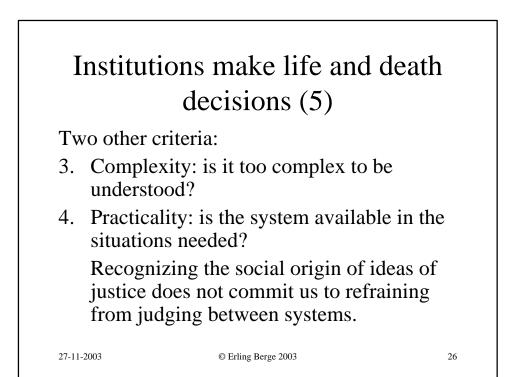






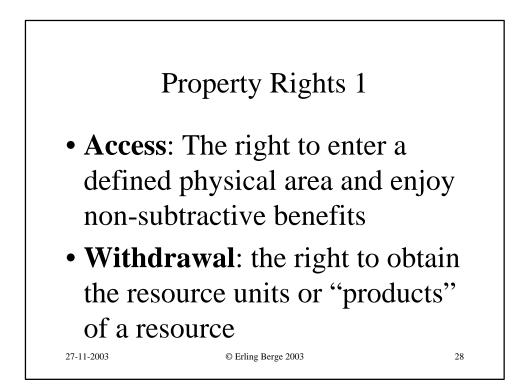






#### Ostrom and Schlager 1996 Classification of Goods

	Excludable	Non-excludable	
RESOURCE IS			
Subtractable	PRIVATE	COMMON	
	GOODS	POOL GOODS	
Non-	CLUB	PUBLIC	
subtractable	GOODS	GOODS	



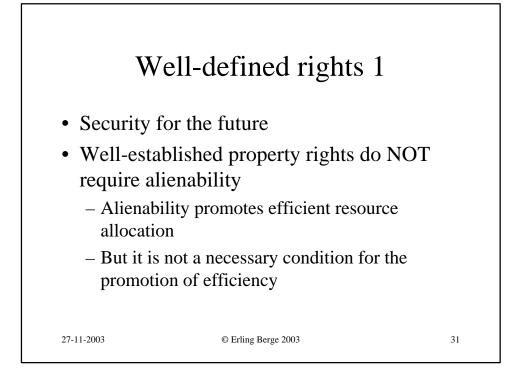
## Property Rights 2

- **Management**: The right to regulate internal use patterns and transform the resource by making improvements
- **Exclusion**: The right to determine who will have an access right, and how that right may be transferred
- Alienation: The right to sell or lease either or both of the above collective-choice rights

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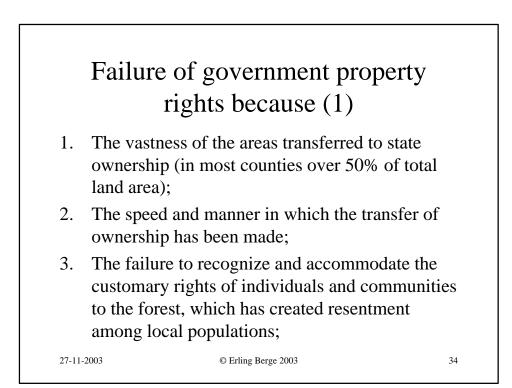
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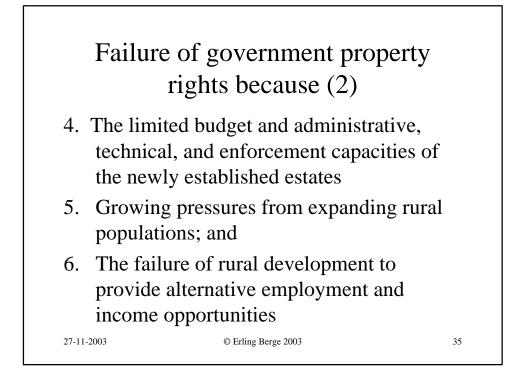
manage resources: management roles							
Rights of	Owner	Proprietor	Authorised claimant	Authorised user	Authorised entrant		
Access	X	X	X	X	X		
Withdrawal	X	X	X	X			
Management	X	X	X				
Exclusion	X	X					
Alienation	X						

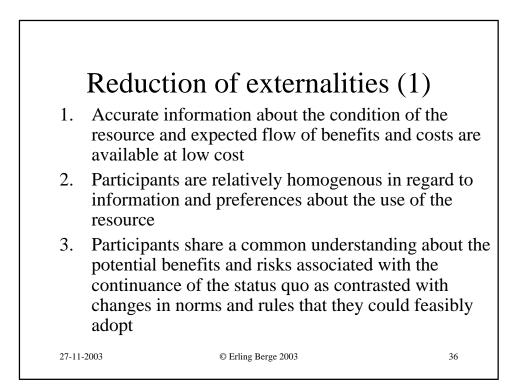


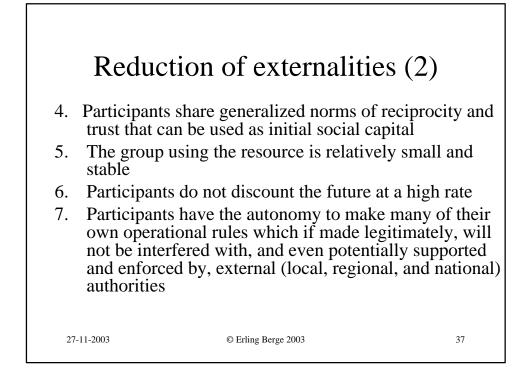


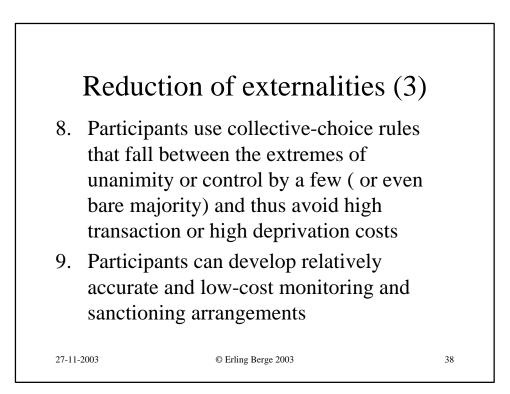


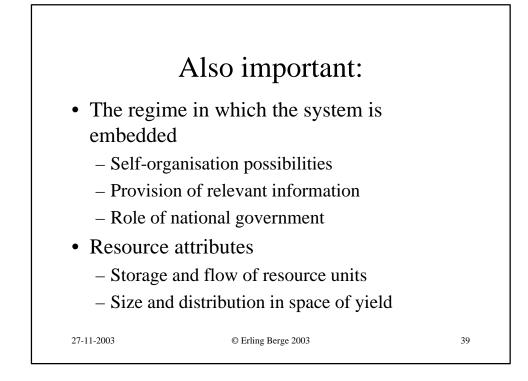


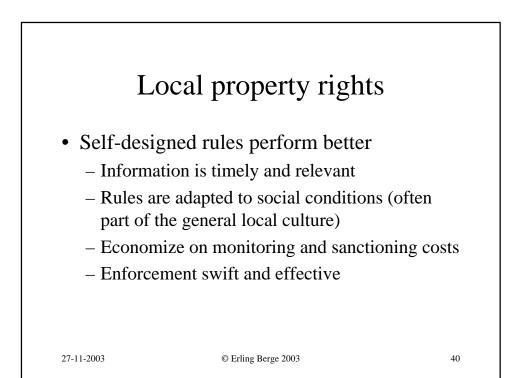


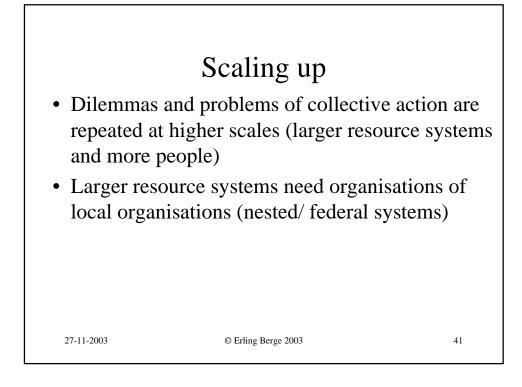


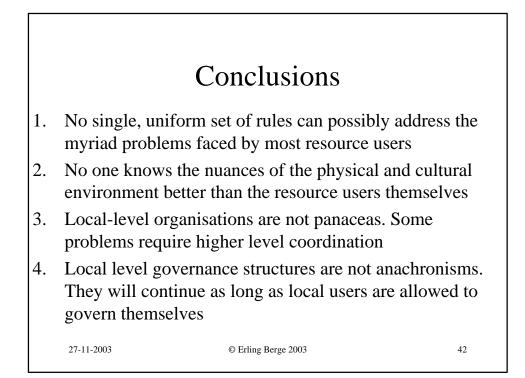


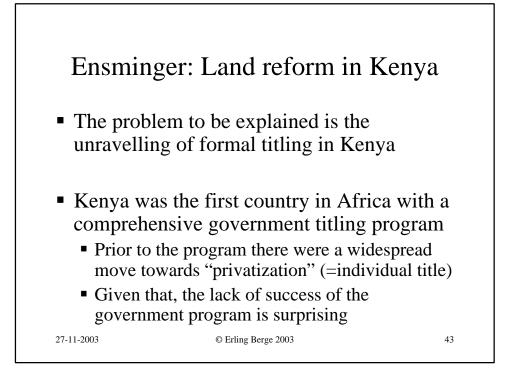


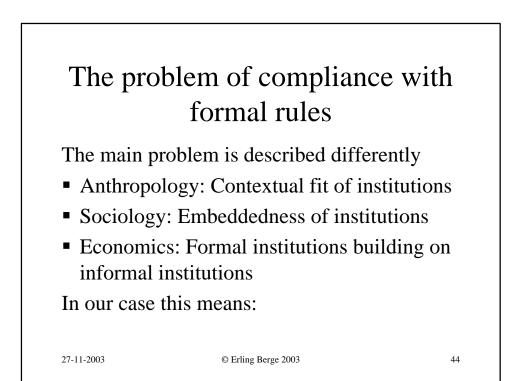










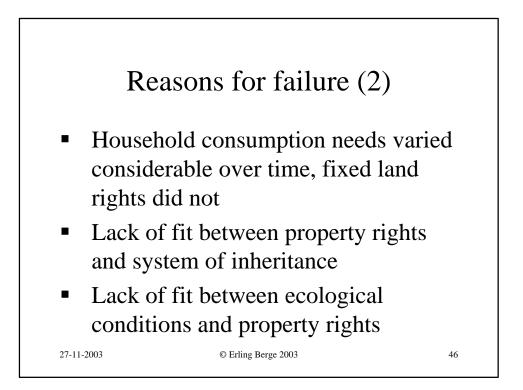


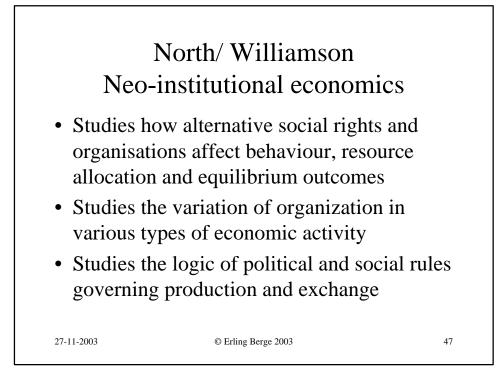
## Reasons for failure (1)

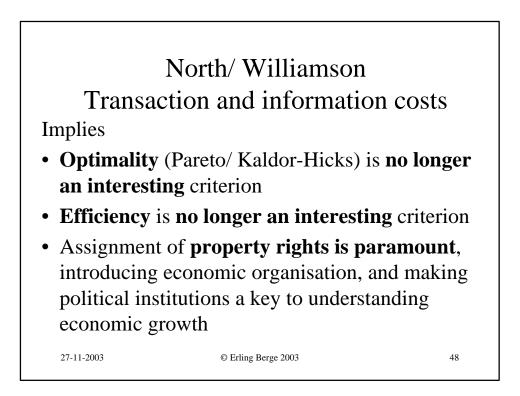
- High transaction costs
- Lagging factor markets in capital and labour
- Asymmetric information work to the advantage of the better educated in the establishment of property rights,
- Lack of "fit" between property rights and system of production

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#### North/ Williamson Transaction costs

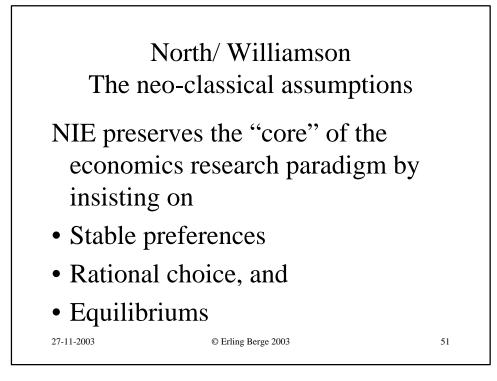
- "The fundamental idea of transaction costs is that they consist of the cost of arranging a contract ex ante and monitoring and enforcing it ex post, as opposed to production costs, which are the costs of executing a contract." (Matthew 1986)
- When information is costly, many exchanges give rise to transaction costs

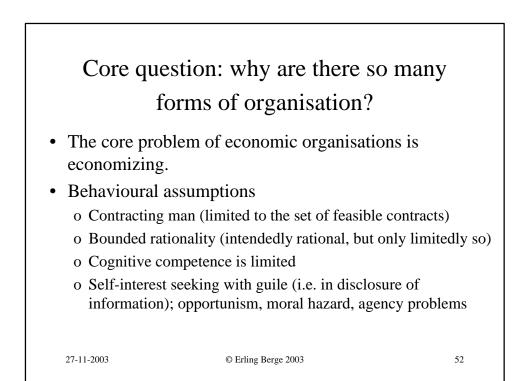
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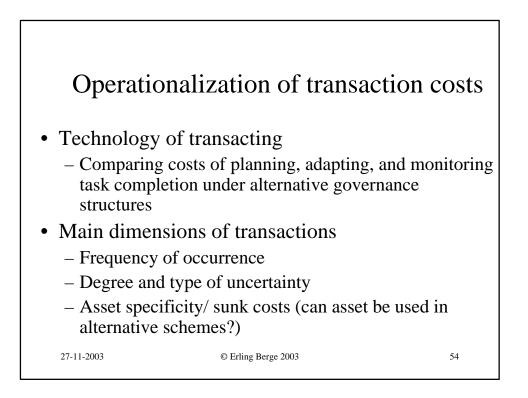
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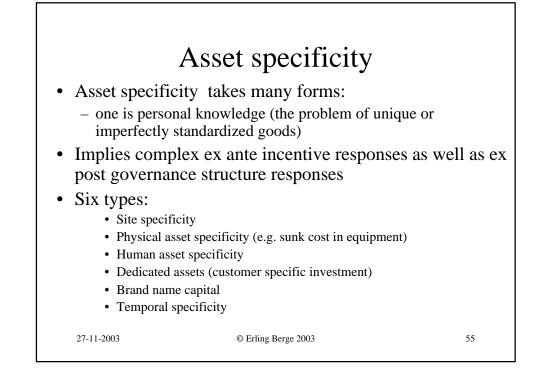
 North/ Williamson Measurement
 Measurement cost will affect systematically the structure of contracts and the organisation of economic institutions.
 State regulations are often directed at lowering measurement costs, not only redistribution. Sometimes the goal is better measurement of the tax base: redistribution and growth are not necessarily opposites.

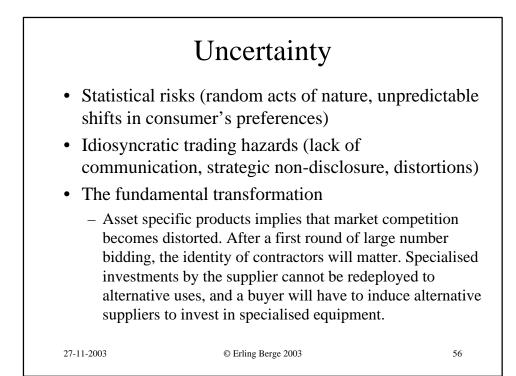












#### More about the Firm: What is it?

- A set of long term contracts between input owners
- The firm replaces the product market with a factor market where price signals plays a minor role

But not in the unitary firm (the one-person firm) who

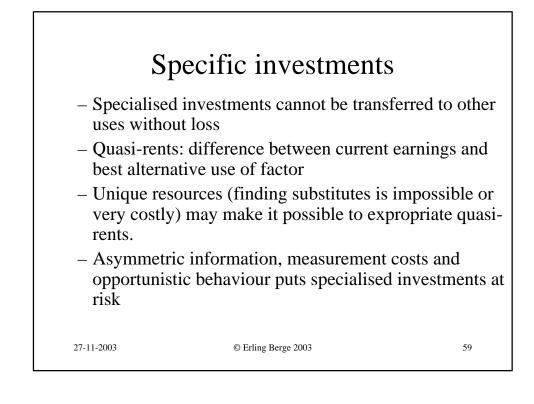
- Discover and produce commodities with valuable dimensions related to form, location, and time
- Is rewarded by profits

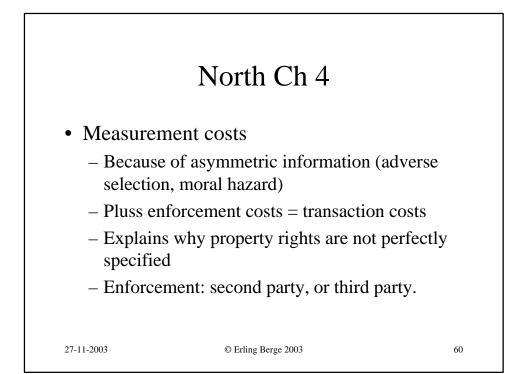
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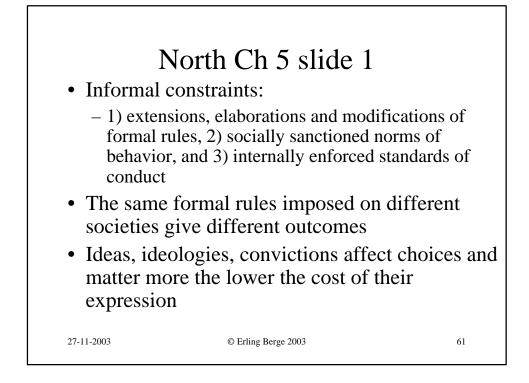
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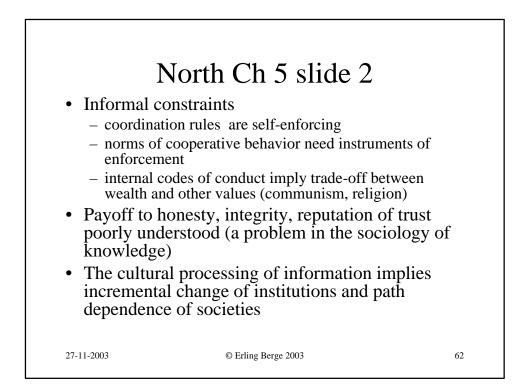
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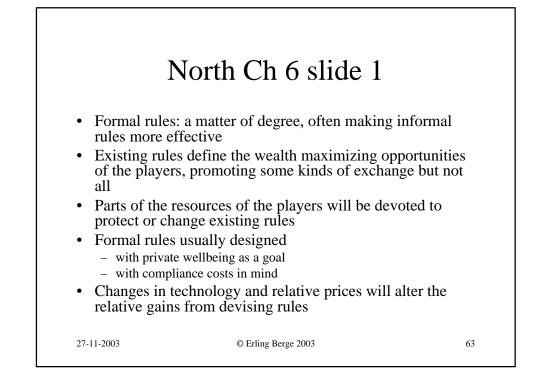
Entrepreneurs and measurements
With full information entrepreneurs are not needed
The person whose contribution is most difficult to measure will assume the role of entrepreneur
Information about entrepreneurial activities are asymmetrically distributed, giving rise to moral hazard problems best solved by the self-monitoring of the entrepreneur as residual claimant
Shirking in coalitions solved by entrepreneur

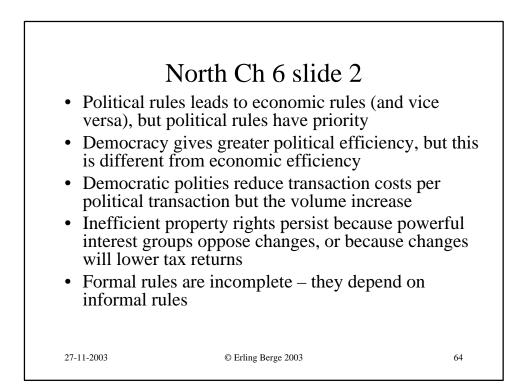


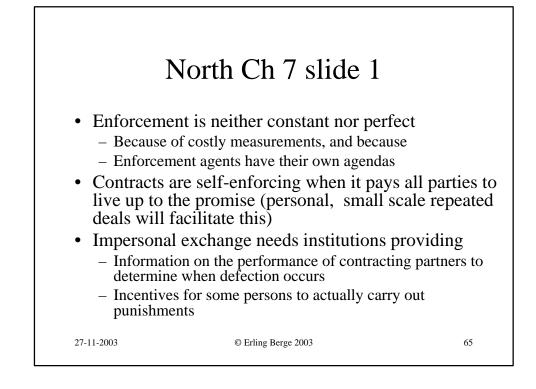


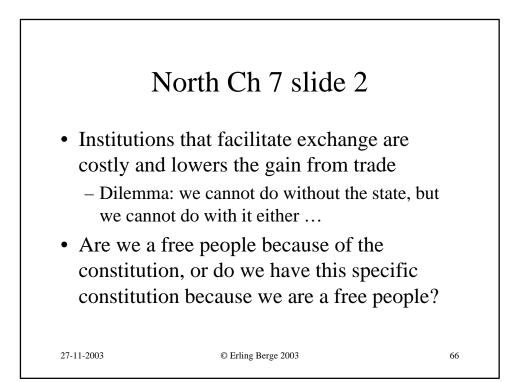


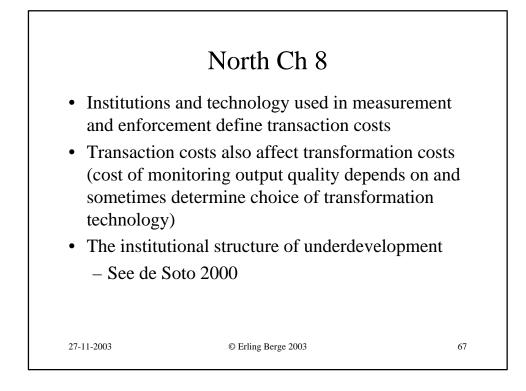


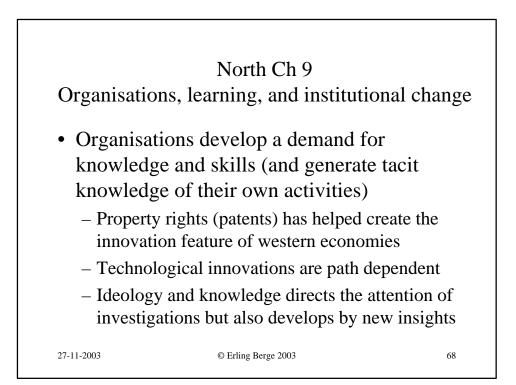










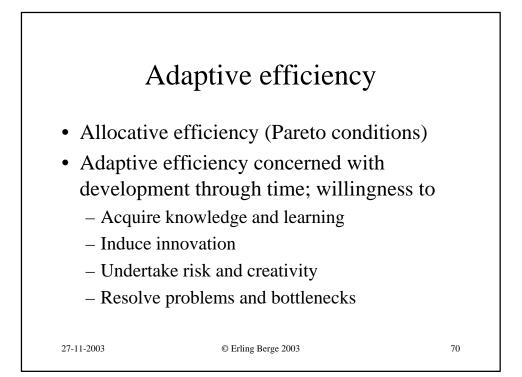


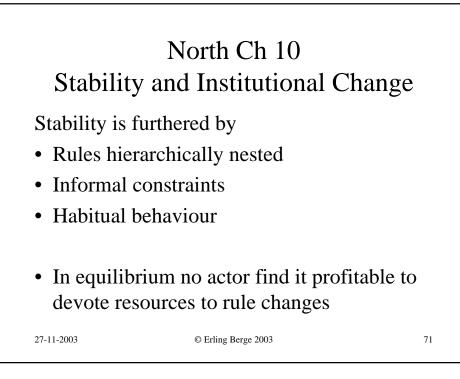
# Institutional change

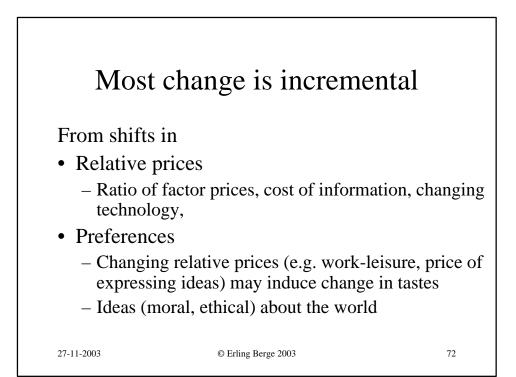
- From the particular demands for knowledge
- Shaped by interactions of
  - Existing institutions,
  - Stock of knowledge and
  - Maximising behaviour of agents
- Incremental changes in informal constraints caused by maximising behaviour

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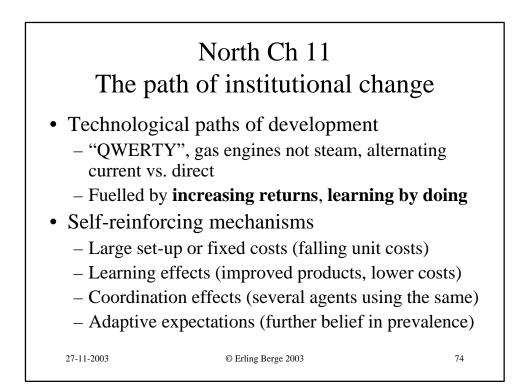


### Discontinuous change

- Does the institutions allow incremental change?
- Does the preferences allow bargaining and compromise?
- Successful revolutions require coalitions making final outcomes uncertain
- Successful revolutions require ideological commitment to overcome free riding
- Discontinuous change is not so very discontinuous!

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# **Competing Technologies**

#### **Consequences of self-reinforcement**

- Multiple equilibria (outcomes indeterminate)
- Possible inefficiencies (best T may have bad luck)
- Lock-in (once a solution is reached, exit difficult)

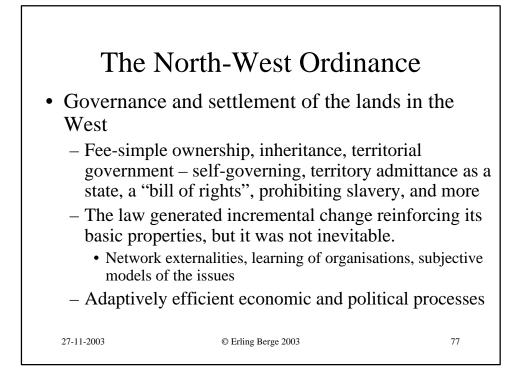
#### • Path dependence

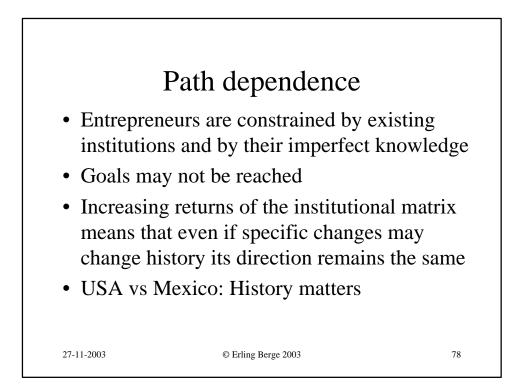
In reality the competition is between organisations employing the technology (institutions)

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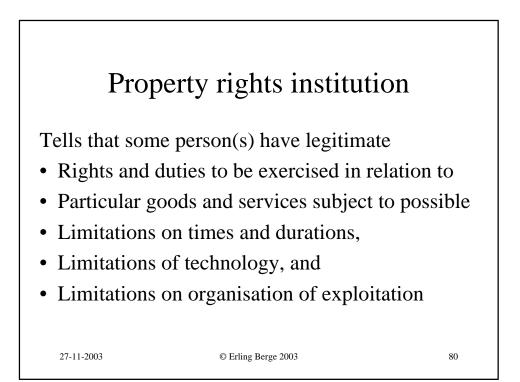
### Institutions are

Humanly devised rules with some Humans mandated to monitor and sanction rules

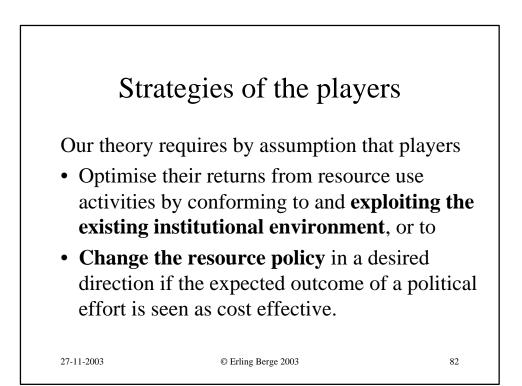
- Created to aide in collective actions problems to safeguard life and livelihoods
  - Avoid conflicts, create justice
  - Allocate legitimate benefits and duties, profits and costs
  - Economize on transaction costs
- Not created to achieve efficiency or optimise economic performance(of the neo-classical model)

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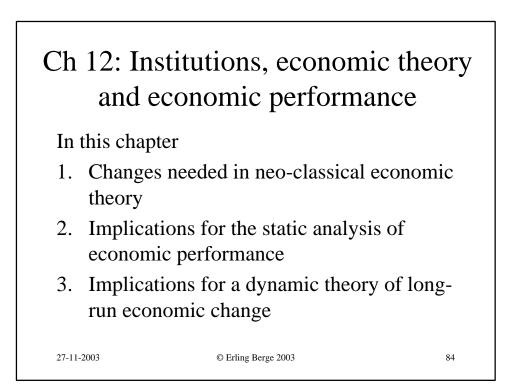
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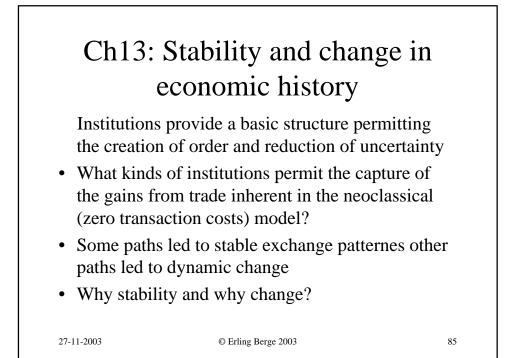


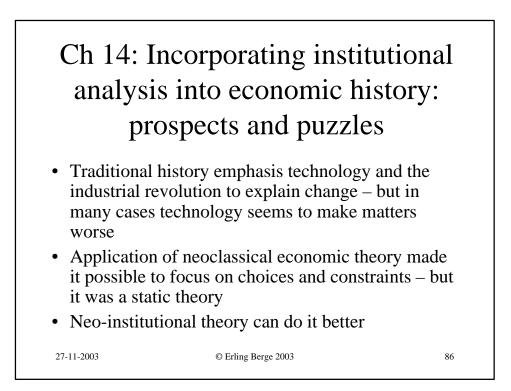


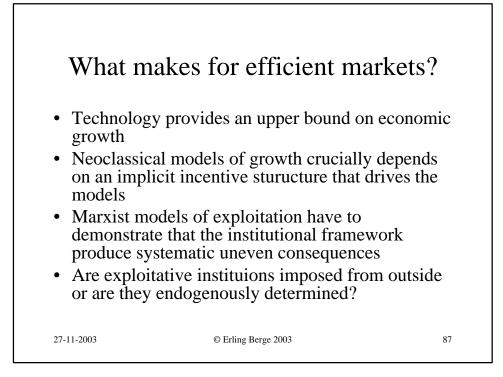


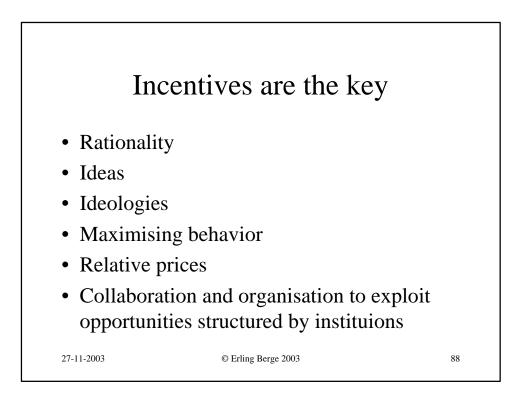


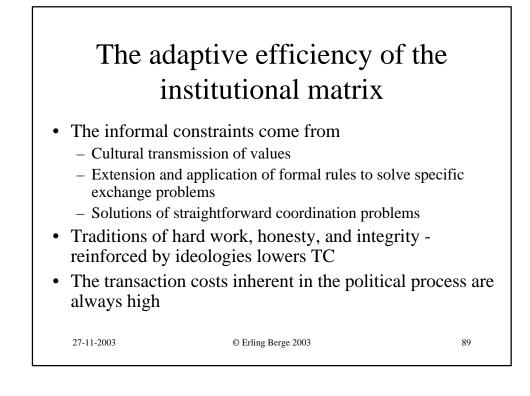


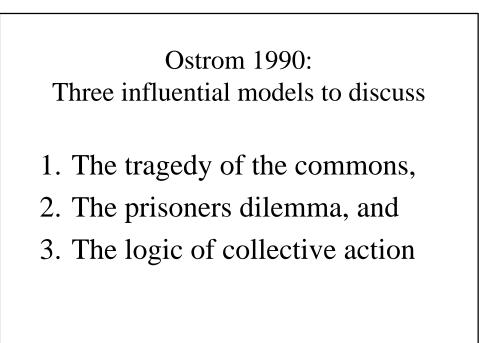


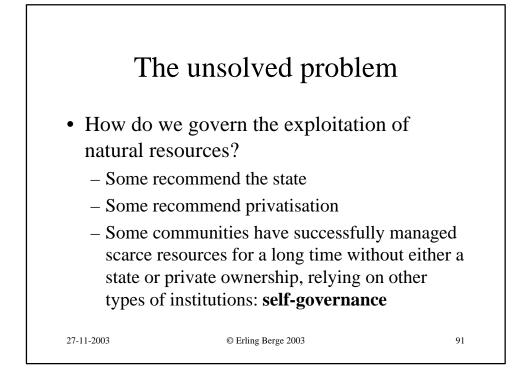


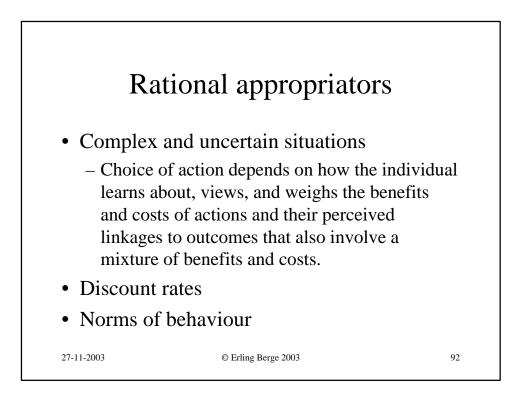


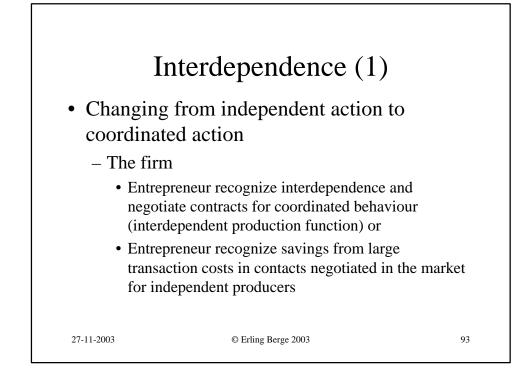


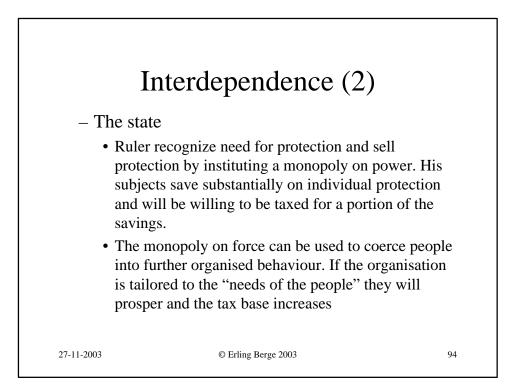










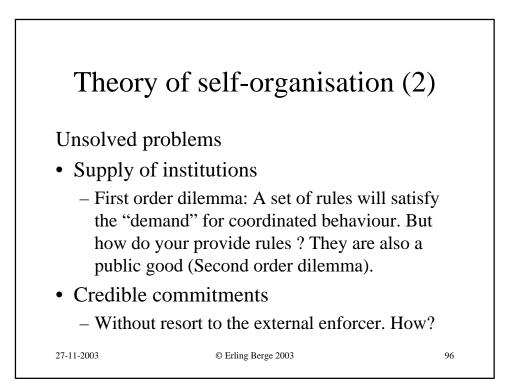


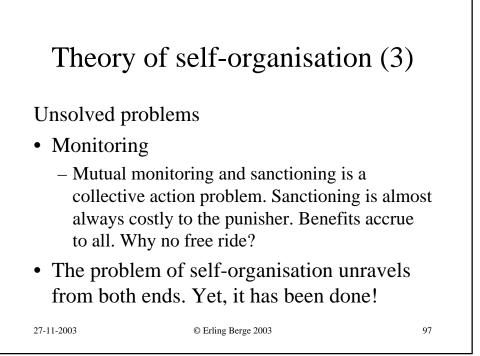
### Theory of self-organisation (1)

- Problems of **Open access CPR**: rent dissipation
- Problems of **Limited access CPR:** incentives depends on rules governing
  - Quantity,
  - Timing,
  - Location, and
  - Technology of appropriation. And how these are
    - Monitored and Enforced.

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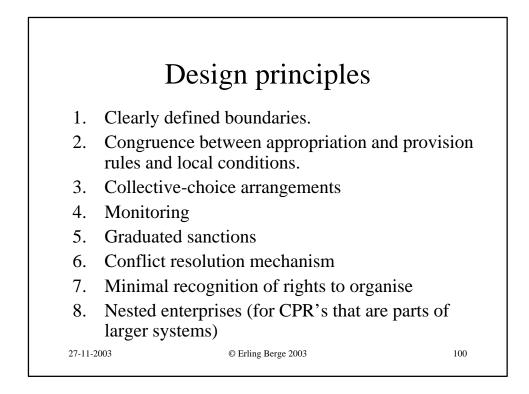


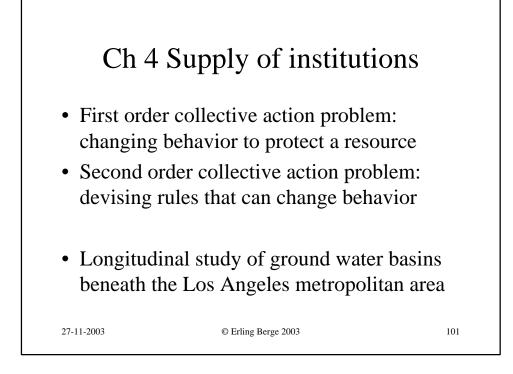
# Long enduring institutions

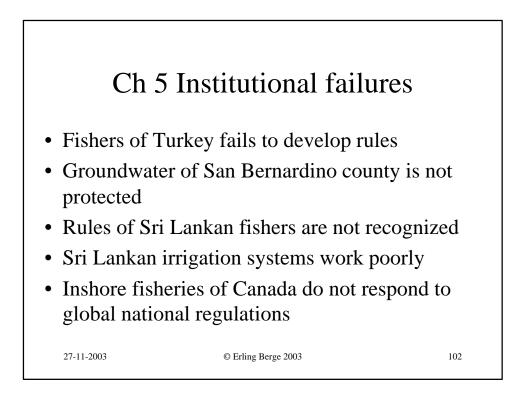
- Complex and uncertain environments
- Stable populations of basically equal individuals with common history and shared norms
- Sustainable robust institutions: why?
  - Operational rules vary
- 7 design principles that will affect incentives in such a way that appropriators will be willing to commit themselves to conform to operational rules devised in such systems, to monitor each other's conformance, and to replicate the CPR institutions across generational boundaries.

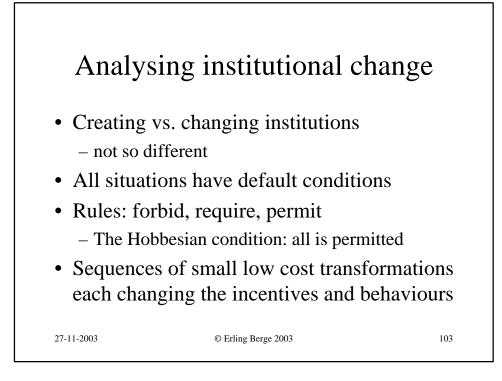
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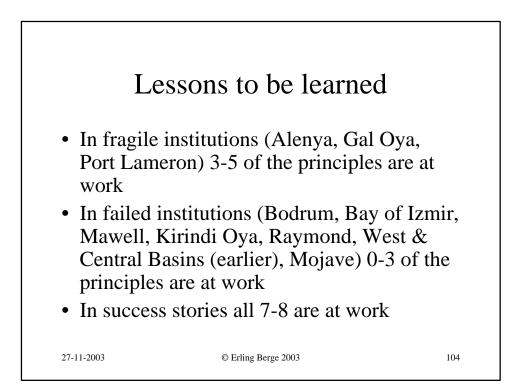
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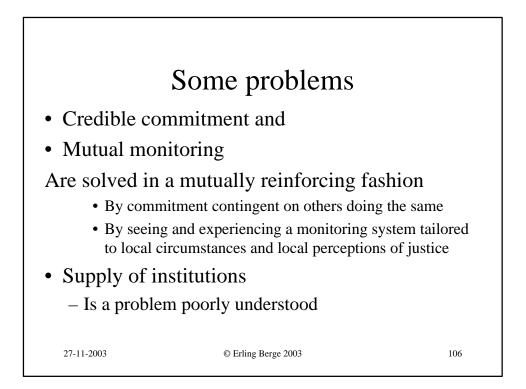


# Modelling for policy purposes

- Models used out of range
- Models used metaphorically
- Models of static structures
- We need models saying what individuals can do to shape or reshape the situations within which they must make decisions and bear the consequences of actions taken on a day-to-day basis

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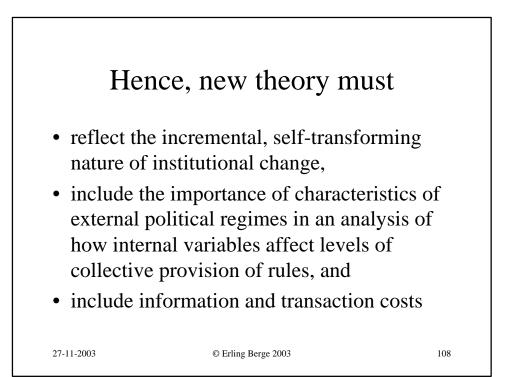


Current theory says it is increasingly difficult to achieve collective beneficial action with increase in

- The total number of decision makers
- The number of participants minimally necessary to achieve the collective benefit
- The discount rate in use
- Dissimilarity of interests, and
- The absence of participants with substantial leadership experience or other assets

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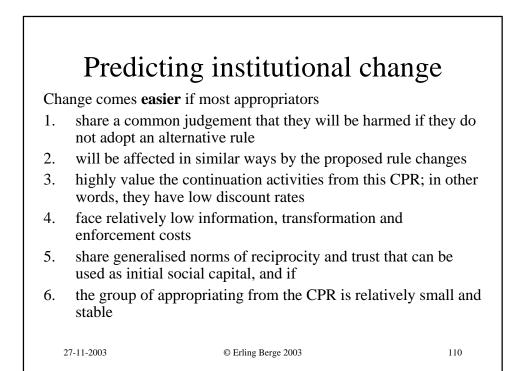
### Judging complex processes

Instead of maximizing profits, judgements of uncertain costs and benefits is a better approach. Known biases in the choice of new rules

- Losses are felt to be more important than gains
- Immediate up-front costs more important than future costs
- Frequency dependent probabilities are difficult to estimate, recent events are given unreasonable weight

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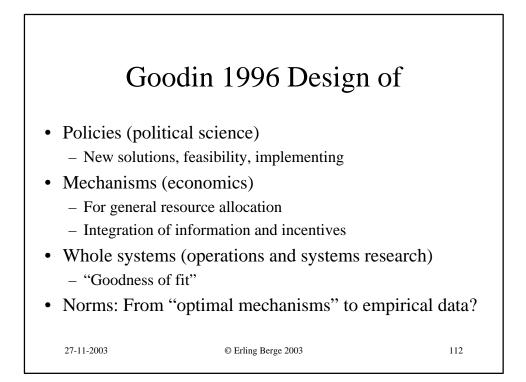


#### External governments are crucial

• The role of external governments are crucial. But not by imposing central governance and control. Their positive role is by providing incentives for the local development of solutions. By providing low cost information, arenas for institutional choice, and agencies for low cost conflict resolution.

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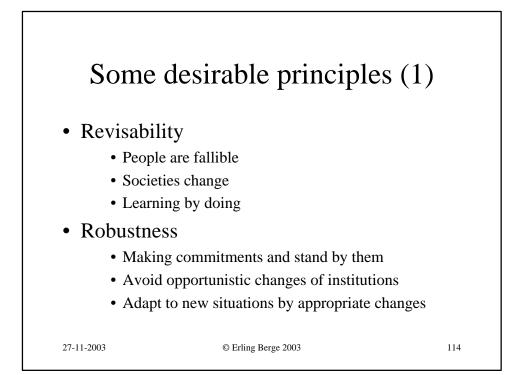


#### Design criteria and morality

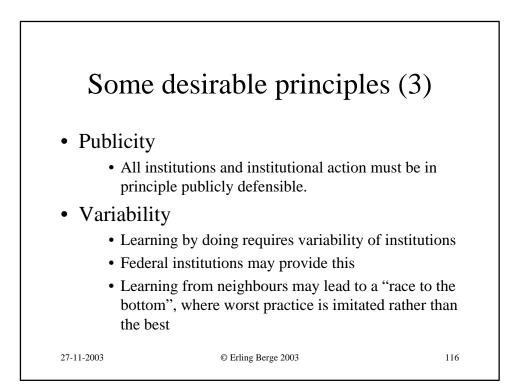
- Internal and external "fit", but what of its
- Moral worth?
- Is good fit really GOOD?
- Not all environments deserve institutions that optimise their values (e.g. slavery)
- The goodness of fit criterion has to appeal to some larger moral code

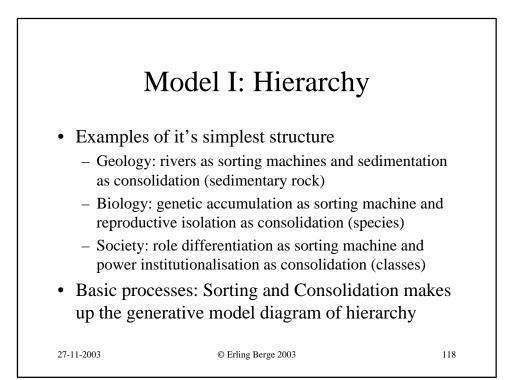
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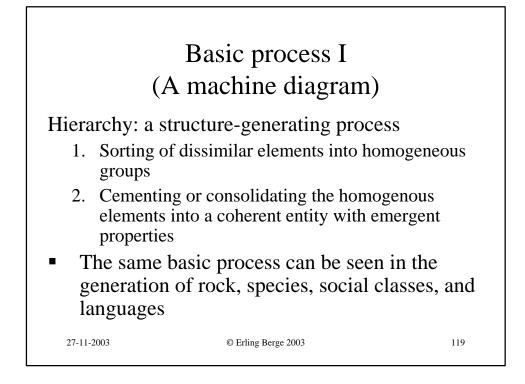
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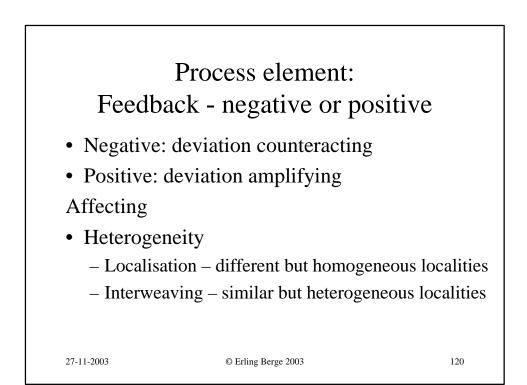


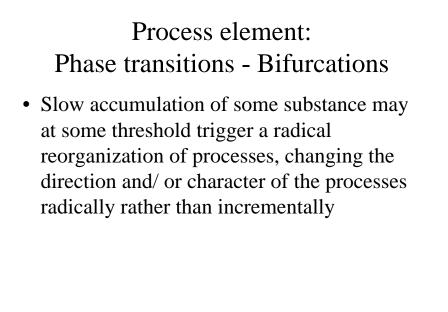






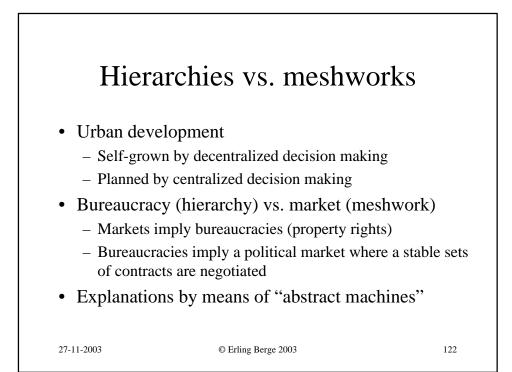


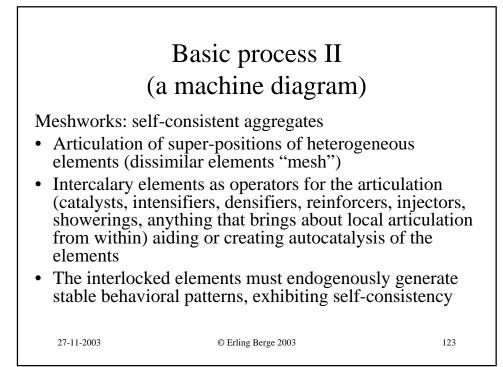


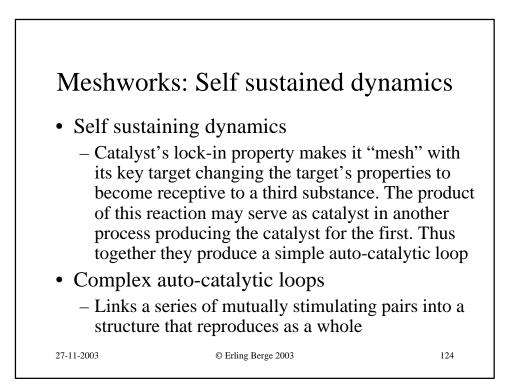


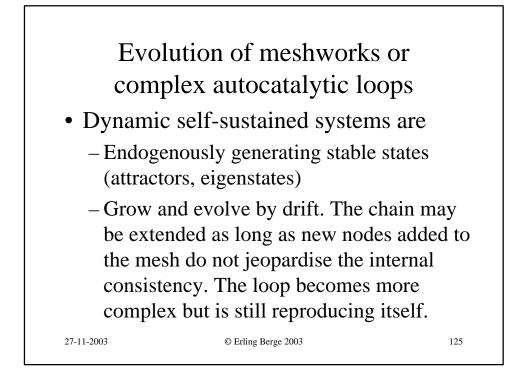


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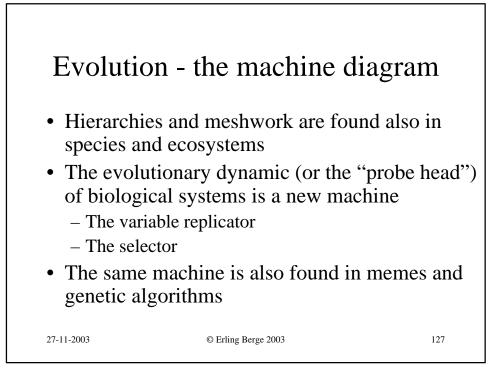


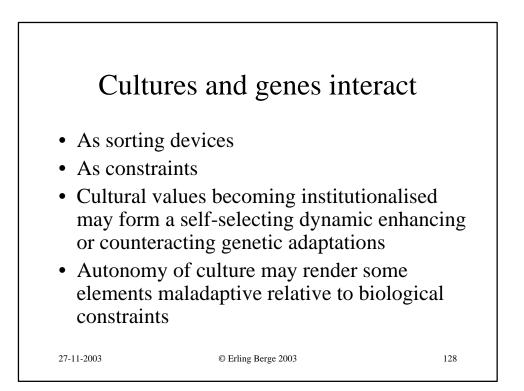


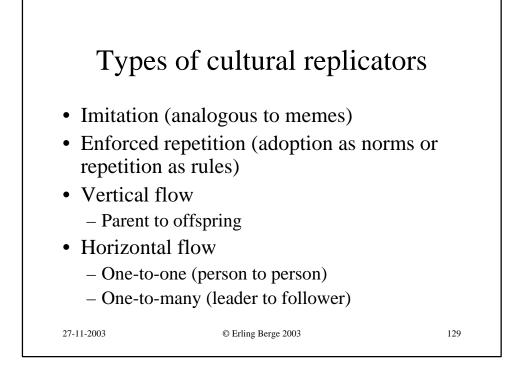


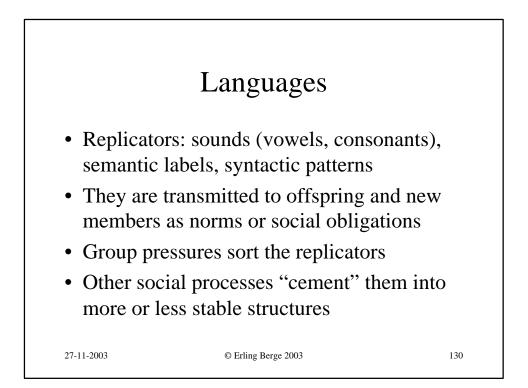


Examples		
	Hierarchy	Meshwork
	- consolidation	- catalysis
geology	Sandstone	Granite
	- sedimentation	- crystallization
biology	Gene pool	Ecosystem
	- isolation	- symbiosis
society	Social Classes	Markets
	- power distribution	- money, norms









# Designing self-governing institutions: models of genesis

- Genesis of form from immanent causes - Such as phase transitions/ bifurcations
- Self-organising processes.
  - Such as attractors
- From here to there: the adjacently possible
- Norms, languages, rules and bureaucracies

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