Course description “Introduction to Institutional Economics”

Institutions define “the rules of the game”. We will look at four kinds of problems that may require particular rules: cooperation problems, coordination problems, imperfect information and concentration of market power, and we will see how these problems give rise to transaction costs. The presence of transaction costs in turn gives rise to the relevance of governance structures, e.g. whether transactions are better executed within a firm or on a market. We will have a closer look at the possible governance structures in the light of the problems mentioned above. Besides the governance structures that private parties can choose, another option to deal with the above problems is state intervention, which may come along with its own specific problems, on which institutional economics offers a perspective as well.

In this course, you will be exposed to the following questions: What are institutions? How do they come about? How are they embedded? How do they change? How do economic outcomes depend on the institutional framework? What kind of institutions are suitable to tackle cooperation problems, coordination problems, and problems originating from an asymmetric distribution of information or a concentration of market power? What are transaction costs, what are their origins, and how to minimize them? What are potential problems when the state intervenes?

Learning goals

Your course work is supposed to enable you to give answers to the above questions, and to:

- explain the role of institutions as solutions for social dilemmas, coordination problems and to govern transactions,
- assess the relevance of transaction costs for different kinds of transactions and the suitability of different mechanisms to reduce transaction costs in the presence of imperfect information,
- point at institutional differences as possible explanations for differences in behavior and performance,
- apply concepts and arguments from institutional economics to simple problems, and to
- evaluate alternative institutional solutions.

Key concepts

Institutions, (bounded) rationality, social dilemma, trust, coordination problem, equilibrium multiplicity, transaction costs, property rights, public goods, the tragedy of the commons, externalities, asymmetric information, moral hazard, adverse selection, reputation, signaling, (incomplete) contracts, hold-up problem, asset specificity, commitment problem

Prerequisites

Ideally, you have completed the course “Introduction to Economics” before this course. In particular, we take it for granted that you are familiar with concepts such as utility functions, optimization, or Pareto efficiency, and we assume that you are comfortable with taking derivatives, taking expectations of simple lotteries, and simple algebra.
You will find most of the material covered in one (or both) of these text books:

- Groenewegen, Spinthoven & van den Berg (2010): Institutional Economics—An Introduction. Palgrave MacMillan.
- Voigt (2019): Institutional Economics—An Introduction. Cambridge University Press.

Course format

The course takes a flipped-classroom approach: The content is delivered in ILIAS learning modules for self-studying. In the weekly meetings, we will consider specific problems and deepen the discussion of selected concepts. The course is digitally enriched with quizzes, exercises and online discussions.

Outline of the content in the learning modules

The learning modules contain a material mix that is organized to best be studied in the presented sequence, but you can also navigate freely.
You will find a collection of the slides that appear in a learning module on its front page along with a barrier-reduced Word-file.
If you face difficulties to access any of the media that we use to convey the content (e.g., due to a visual impairment), please let us know and we will offer a more accessible substitute.

LM 1: Introduction
We will look at several conceptualizations of institutions, distinguish between perspectives from different schools, and spell out the viewpoints that are particular to institutional economics. We also look at the ways in which institutions are established and possibly change.

LM 2: Social dilemmas
We will capture social dilemmas (public good provision, the tragedy of the commons, dealing with externalities) in a simple normal form game ("the prisoner's dilemma") and analyze it with game-theoretical methods. Thereafter, the perspective on the problems is broadened and institutions to deal with them are being discussed.

LM 3: Coordination problems
We will introduce coordination problems in strategic situations without underlying conflicts of interests, and we will discuss institutions as solutions to such problems and as obstacles to overcome inefficiencies. Broadening the perspective, we will look at the problem of coordinating economic activities.

LM 4: Imperfect information and market power
We will introduce imperfect information and market power as deviations from perfect markets, derive their consequences for economic outcomes, and analyze institutions to deal with these problems.

LM 5: Transactions, transaction costs and their origins
We will illustrate how information imperfections, a lack of property rights, an incompleteness of contracts, and other frictions give rise to transaction costs. We will introduce the concept of asset specificity and the resulting hold-up problem.

LM 6: Governance structures
We will look at markets, contracts and firms as possible structures to govern transactions, and their differences in dealing with cooperation and coordination problems, transaction costs and uncertainty.

LM 7: State intervention
We will focus on selected problems that may accompany state intervention from an institutional economics perspective. In particular, we will look at the problem of reaching collective decisions, the problem of rent-seeking and the commitment problem.

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