

Institutions defined--

- "a way of thought or action of some prevalence and permanence which is embedded in the habits of a group or the customs of a people." Hamilton
- "Settled habits of thought common to the generality of men." Veblen
- "Rules of the game." North
- "Laws, informal rules...that give a durable structure to social interactions...." Bowles

Institutions defined-- Commons

- "sets of ordered relationships among people that define their rights and opportunities and their exposure to the rights of others, their privileges and responsibilities."

Case: Women in Labor Force

1. Relative prices.
2. Preferences, habit, ideology.
3. Anti-discrimination law.
 - Are costs of raising children a cost of producing cars or legal briefs?

What to hold constant

- The individual.
- Habits
- Formal institutions.
- Technology.
- Human Brain
- Different things at different times and contexts.

Unit of Observation: Transactions

- I am tempted to put **conflict** and **power** at the center of institutional economics.
- And the way conflict is resolved (elements coordinated to different ends) defines economic development.

Economic Systems

- "Field theory does not apply generally to the domain of economic agent interactions."
- Evolving "connections."
- "Selection does not optimize but is irreducibly a historically contingent process."

Complete System

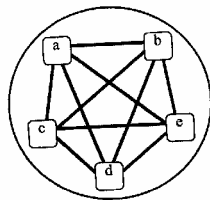


Figure 3.3 A complete system

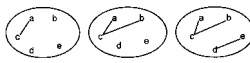
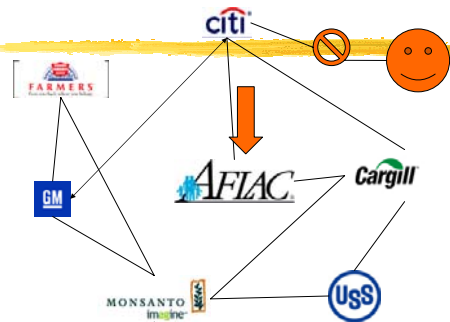


Figure 3.4 Some states in state space

How are firms connected in neoclassical theory?

- Prices

Incomplete Connections



What does it mean to say

- "Prices are social conventions?" Hodgson
- "Cost is a function of rights." Samuels
- Informal conventions & formal rights help form prices and costs.

Applications

- a. Sticky prices in recession.
- b. Flood insurance purchase behavior.
- c. Growth in women's entry to the workforce. Persistent gap in salaries.
- d. Rising health care expenditures.

Review Questions: Some questions to ask yourself after reading to see if you understand:

1. **Are externalities a special case?** What is the problem with the usual textbook definition?
What is the difference between a spillover and an ordinary production input?
2. **Can freedom be a general goal** for all and a criterion to judge alternative institutions? Evaluate this proposition:
"I seek no power,
I just want to be left alone."
3. **Is any economy unplanned?**
4. **Can value maximization be a criterion** to judge alternative institutions?

Sound Bites

- **Externalities are ubiquitous.**
- **Power is unavoidable.**
- **All economies are planned.**
- **Cost is not natural.**

More Sound Bites

- * The chicken **and** the egg came first.
- * Preferences are learned, not just economized.
- * Cognition matters.
- * Habits matter.

Major themes of Part I

- Economizing.
- Power
- Knowledge. Incl. Habits, meaning,....

- Learning (of preferences).
- Bounded rationality.
- Evolution of "connections."