

Econ 5370  
Fall 2016  
T Th 10:45 – 12:05

Dr. Erturk  
Office: Bldg 73 Rm 240  
Office Hrs: W: 1-2

## Econ 5370: Markets and Governance Institutions: The Economics of Collective Action

Objective: The course is designed to introduce students to new developments in institutional economics to provide an intuitive yet rigorous study of strategic behavior under different institutional settings. The hope is that students will come out of this class with a firm understanding of the decisive role Institutions play in whether markets thwart or amplify negative externalities and market failures caused by enforcement and information problems.

Synopsis: As we pursue our own economic ends in a market economy the effect our actions have on others' wellbeing is called externalities. Given the increased web of social connectedness in modern life, the more complex a market economy is the more ubiquitous they are. That poses a potential threat. The generalized pursuit of self-interest is socially optimal the way Adam Smith had envisioned only in the absence of market failures externalities can cause. The issue boils down to whether at the individual level one's self-seeking behavior clashes with his concern for others, especially when his actions indirectly harm their wellbeing without making him/her legally liable. In a foregone simpler world, the fear of being shunned by their communities could constrain opportunistic self-seekers and make them socially liable for their actions. But, today we trade ever more with anonymous others with whom we might share few social bonds and common values and thus can hardly rely much on a shared sense of civic duty and virtue. Moreover, the problem is compounded by the increased complexity of goods and services produced in our knowledge based economy that creates ample new opportunities for socially costly opportunistic behavior on the part of both firms and customers. If we can no longer rely on common social ties and the community's approbation for social responsibility the next best thing is to fashion institutions that work reasonably well in their absence. Whether a market economy works well or not then depends very much on the type of institutions that prevent socially costly forms of self-seeking and the market failures and externalities they cause.

Readings are selected chapters from:

Prasch, R. (2008). *How Markets Work*  
Cassidy, J. (2009). *How Markets Fail*  
Hardin, R. (1995). *One for All. The Logic of Group Conflict*  
North, D. (1981). *Structure and Change in Economic History*  
Bates, R. (2010). *Prosperity and Violence*

and, following articles:

- Fehr, E. & S. Gächter (2000). "Fairness and Retaliation: the Economics of Reciprocity," *Journal of Economic Perspectives*, 14, pp. 159-81.
- Greif, A. (2000). "The Fundamental Problem of Exchange: A Research Agenda in Historical Institution Analysis," *European Review of Economic History* 4(3).
- Ostrom, E. (2000). "Collective Action and the Evolution of Social Norms," *Journal of Economic Perspectives*, 14(3), pp. 137-58.

Course Evaluation is based on:

- 5 short exams (50%)
- Term Paper/Project (20%)
- Final Exam (30%)

Provisional Exam Schedule:

- September 13
- September 29
- October 27
- November 15
- December 6
- Final Exam Date to be announced

## Course Outline

- I. Review of Standard Micro Model - Basic Precepts of Welfare Economics
  - Private vs Social Cost and Efficiency
  - Externalities and other types of Market Failure
  - Readings: Prasch: Lecture II  
Cassidy: Chp. 9 and 10
  
- II. What is ignored in the Standard Model?
  - Spot vs Relational Contracts – Different Types of Markets
  - Information, Enforcement Problems and Network Externalities
  - Strategic Maximizing Behavior
  - Reading: Prasch: Lecture III
  
- III. Examples of Socially Costly Maximizing Behavior
  - Enlightened vs short term self-interest

Prisoner's Dilemma  
Moral Hazard  
Adverse Selection  
Network Externalities

N Person Prisoner's Dilemma

Free Rider Problem and Zero Contribution Thesis  
Common Pool Resources – Tragedy of Commons

Reading: Cassidy: Chps 11 and 12  
Fehr & Gächter (2000)  
Ostrom (2000)

#### IV. Collective Action

Coordination, Cooperation and Clubs  
Market Exchange as Prisoner's Dilemma  
Enforcement of Property Rights and Social (Contractual) Obligations  
Risk Management and Private Protection of Property *Rights*

Reading: Hardin: Chp 2  
Grief (2000)

#### V. From Kinship *Clubs* to the Modern State

Organization of Protection and Violence  
Community Responsibility System  
Political Coordination, Power and Network Externalities  
State as a Discriminating Monopolist  
*Contract vs Predator State*

Reading: Bates: Chps 2 and 3  
North: Chp 3