

Chapter 4

Individuals and Community

- Individuals are social and operate in communities
- A community is a group of individuals with a set of shared values
- Some individual's objectives may conflict or compete
- Need for social institutions to coordinate competing values and behavioral patterns
- Social institutions and organizations

Social Institutions

- Institutions are habitual patterns of behavior that are embedded in society
- Institutions arise from human behavior and also influence that behavior
- Examples of institutions are:
 - Markets
 - Money
 - Marriage
 - Halloween
 - Traditions, mores, customs

Douglass North on Institutions

- Institutions are the rules of the game in a society that shape human interaction
- Institutions structure incentives
- Institutions reduce uncertainty (provide structure)
- Institutions may be formal (explicit) or informal (implicit)
- Institutional constraints may be positive or negative
- Institutions are not “organizations”

Organizations and Institutions

- Organizations are one of the players in the game
- Social institutions and organizations both reduce costs
- Ronald Coase and “Transaction costs”
 - There is a cost of using a market exchange
 - A firm is an organization that uses a hierarchical solution to the allocation problem
 - As long as the cost of using the market exceed the cost of using an organization, the organization expands

Institutional Change

- Institutions are creations of human behavior that are intended to solve problems
- Given changes in the natural or built environments, the nature of the problems change and the institutions need to adapt
- Those who benefit from a set of institutions will inhibit change
- Institutional change tends to lag behind technological and environmental changes

Markets and Social Infrastructure

- Markets require:
 - A system of morality – Adam Smith's "*Theory of Moral Sentiments*"
 - Justice and a Stable society
 - A System of law
 - Trust
 - Voluntary Individual choice
 - Nonattenuated Property rights

Agents, Principals and Organizations

- Agent is an individual who has the authority to make a decision or choice and act on it
- An agent can act for a principal
- A conflict between the interests of the agent and principal is called the “Principal-Agent Problem” (Conflict of interest)
- An organization is a small planned society that depends on eminent domain as the primary allocative mechanism

Objectives

- Objectives, goals, ends are synonymous
- Primary goal is survival of individual and/or species, group
- The technique to achieve the goal, objective or end is called the means
- Economics is the process of prioritizing objectives, the “economy is a process of valuation”
- Confusion of ends and means is a problem