

# 3.5 — Introduction to Political Economy

ECON 306 • Microeconomic Analysis • Spring 2023

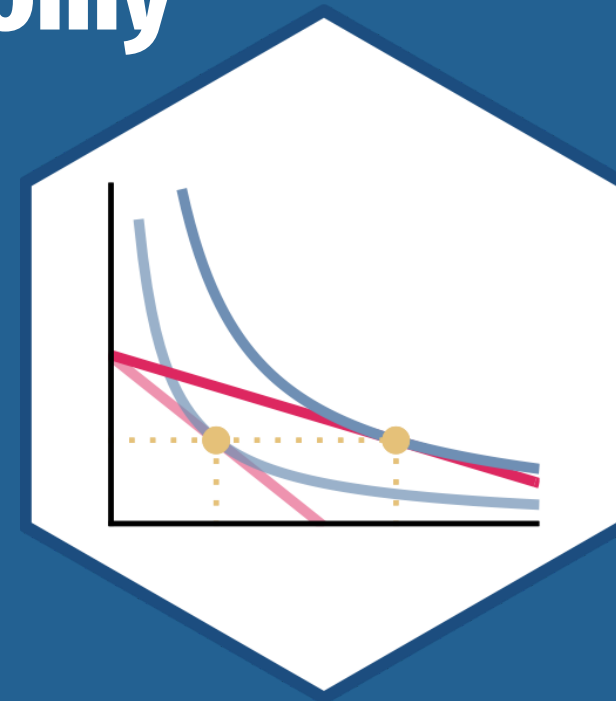
Ryan Safner

Associate Professor of Economics

[✉ safner@hood.edu](mailto:safner@hood.edu)

[🐙 ryansafner/microS23](https://github.com/ryansafner/microS23)

[🌐 microS23.classes.ryansafner.com](https://microS23.classes.ryansafner.com)



# Outline

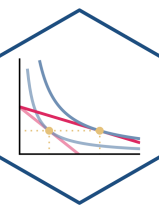


Policies That Raise Transaction Costs & Prevent Equilibrium

An Example: *Some* Economic Impacts of Covid

Making Fair Comparison

# Welfare Economics, Reminder



- **Markets are great when:**

1. They are **Competitive**: many buyers and many sellers
2. They reach **equilibrium** (**prices are free to adjust**): absence of transactions costs or policies *preventing prices from adjusting* to meet supply and demand
3. **There are no externalities**<sup>†</sup>: costs & benefits are fully internalized by the parties to transactions

- **Market failure**: if these conditions are not met
  - May be role for governments, other institutions, or entrepreneurs to fix

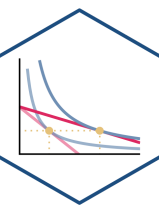


<sup>†</sup> Or public goods, or asymmetric information. But I treat these as special cases of more common externalities.

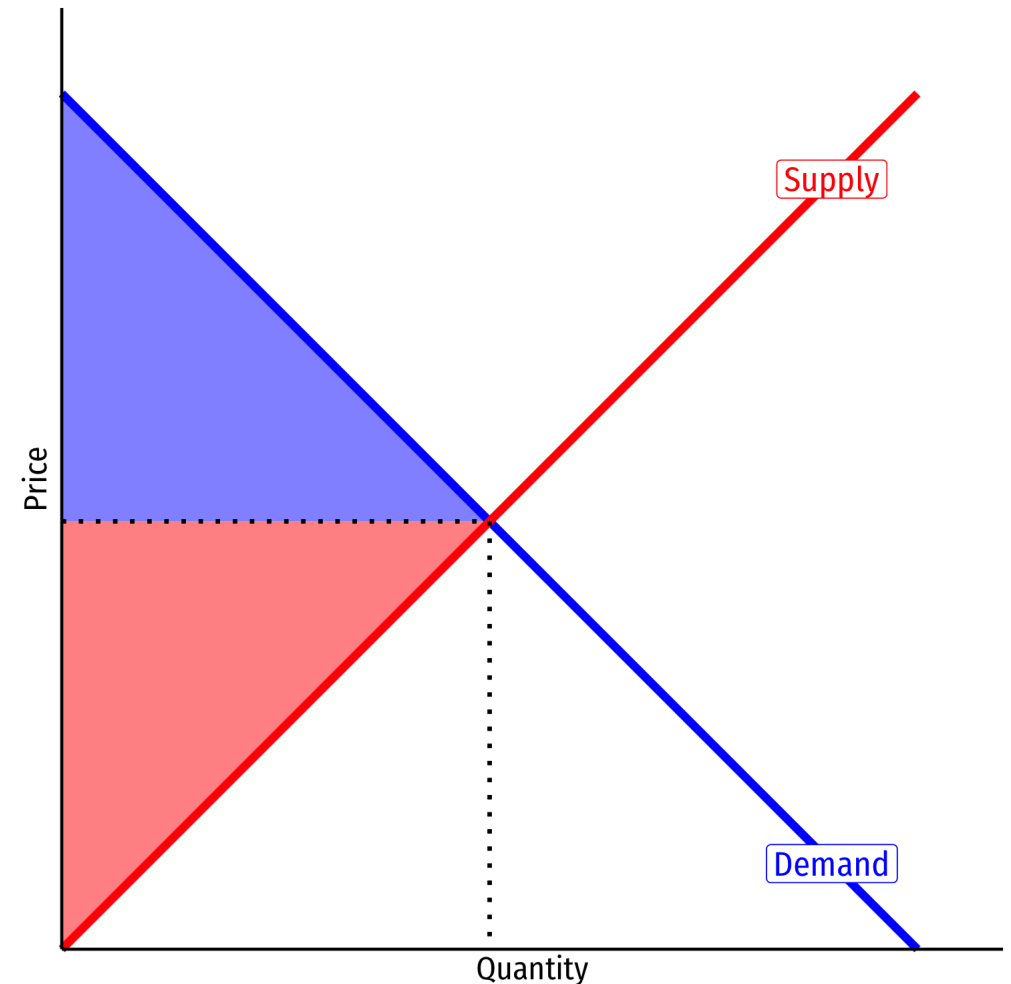


# **Policies That Raise Transaction Costs & Prevent Equilibrium**

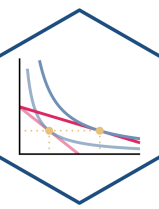
# Dis-equilibrated Markets



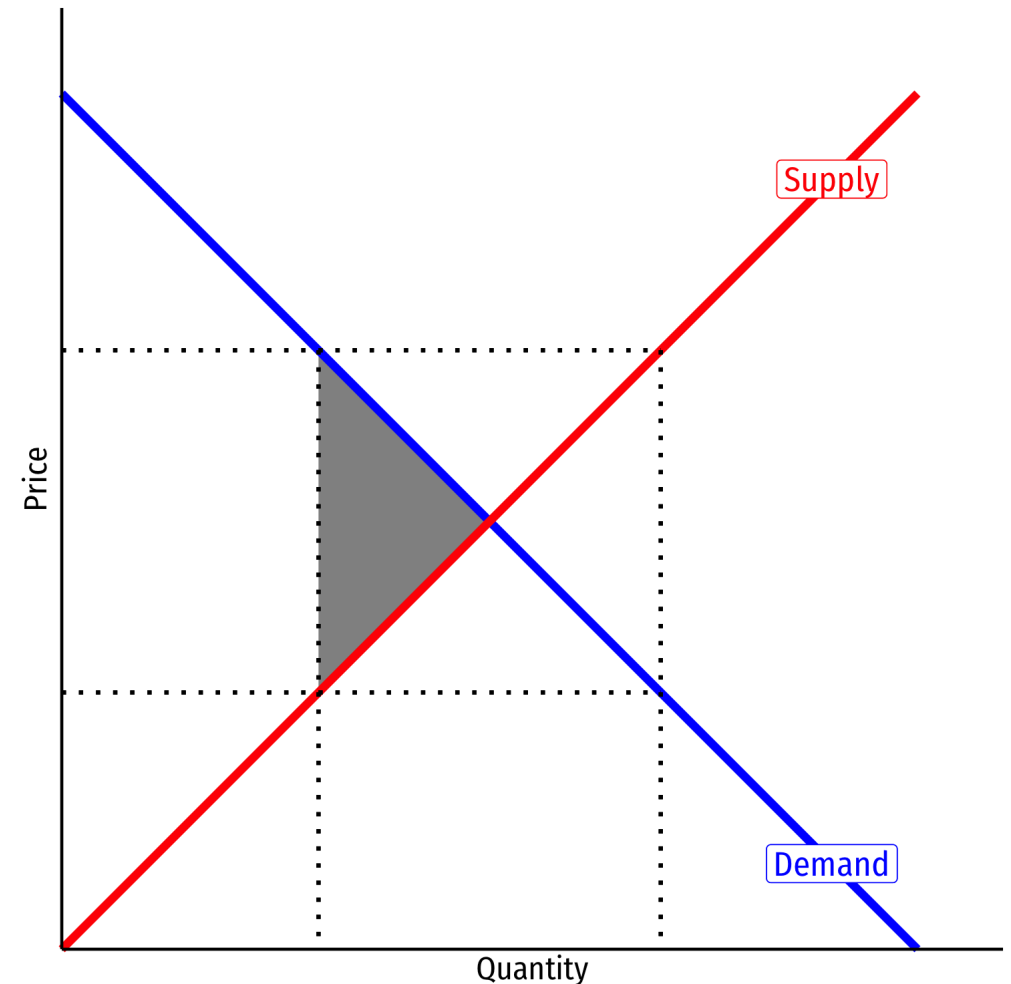
- The **static benefits** of markets all come from markets **being in equilibrium** ([class 3.3](#)):
  - allocative efficiency (**CS+PS**)
  - Pareto efficiency
  - productive efficiency
- But don't forget the **dynamic benefits** of markets as a **discovery process!** ([class 3.4](#))
  - *discovery* of better allocations of resources
  - creation & elimination of profit opportunities
  - entrepreneurship & innovation



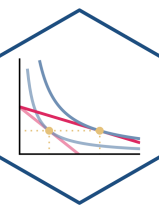
# Dis-equilibrated Markets



- To *reach* equilibrium, market prices need to be able to adjust
  - **Shortage** ( $Q_s < Q_d$ ): price needs to rise
  - **Surplus** ( $Q_s > Q_d$ ): price needs to fall
- There are *unrealized gains from trade* that exist in disequilibrium (shaded)
  - **Buyers** & **sellers** both can be made better off if they can adjust the price

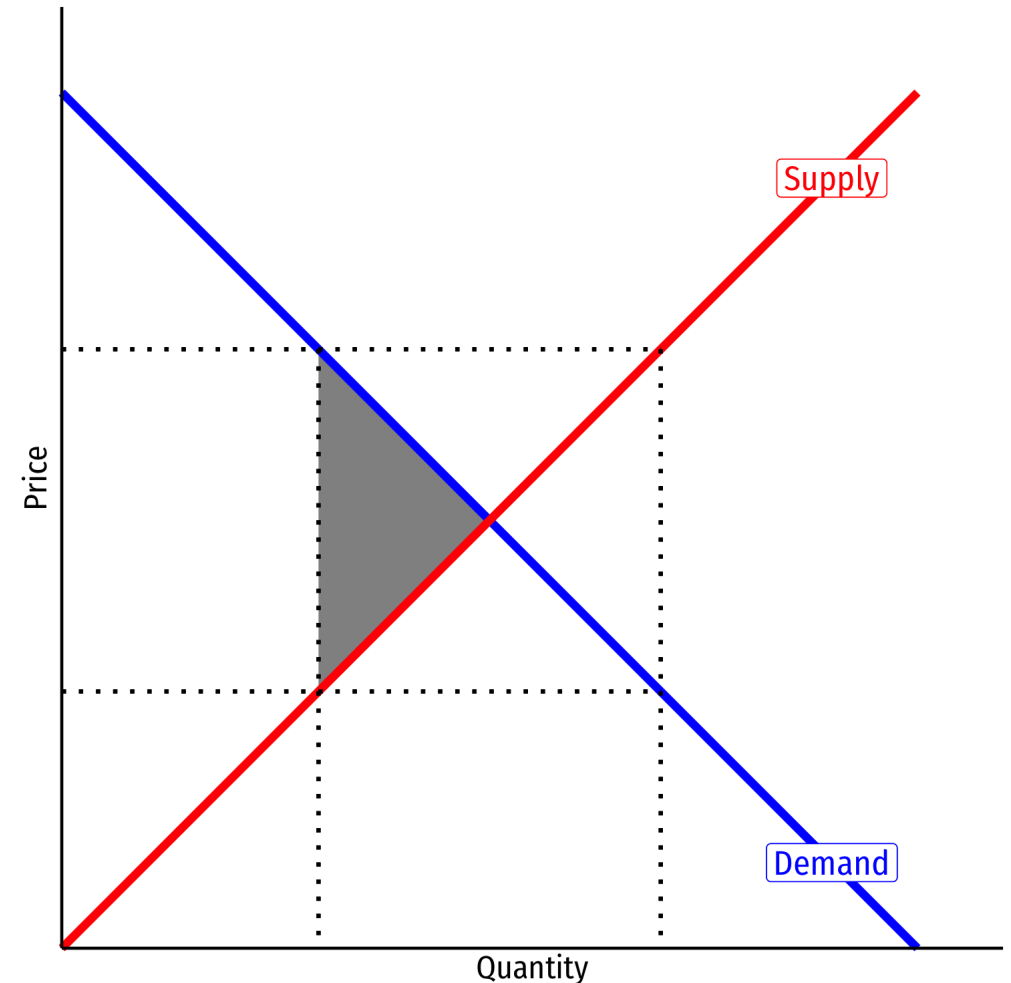


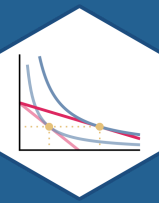
# Dis-equilibrated Markets



- If market prices are *prevented* from adjusting, shortage/surplus becomes *permanent*
- Lost CS and/or PS: **Deadweight loss (DWL)**
  - **inefficiency** created by (permanent) diseq.
- Various government policies can prevent markets from equilibrating & create DWL:
  - **Price regulations** (price ceiling like rent control, price floor like minimum wage)
  - **Taxes, subsidies, tariffs, quotas**<sup>†</sup>
  - These should have been covered in Principles (see my [slides](#) on taxation from ECON 410)

<sup>†</sup> Some may be necessary (taxes fund government), but create market inefficiencies.

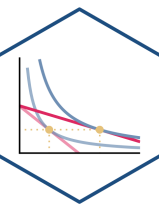




# **An Example: *Some* Economic Impacts of Covid**



# An Example: *Some* Economic Impacts of Covid



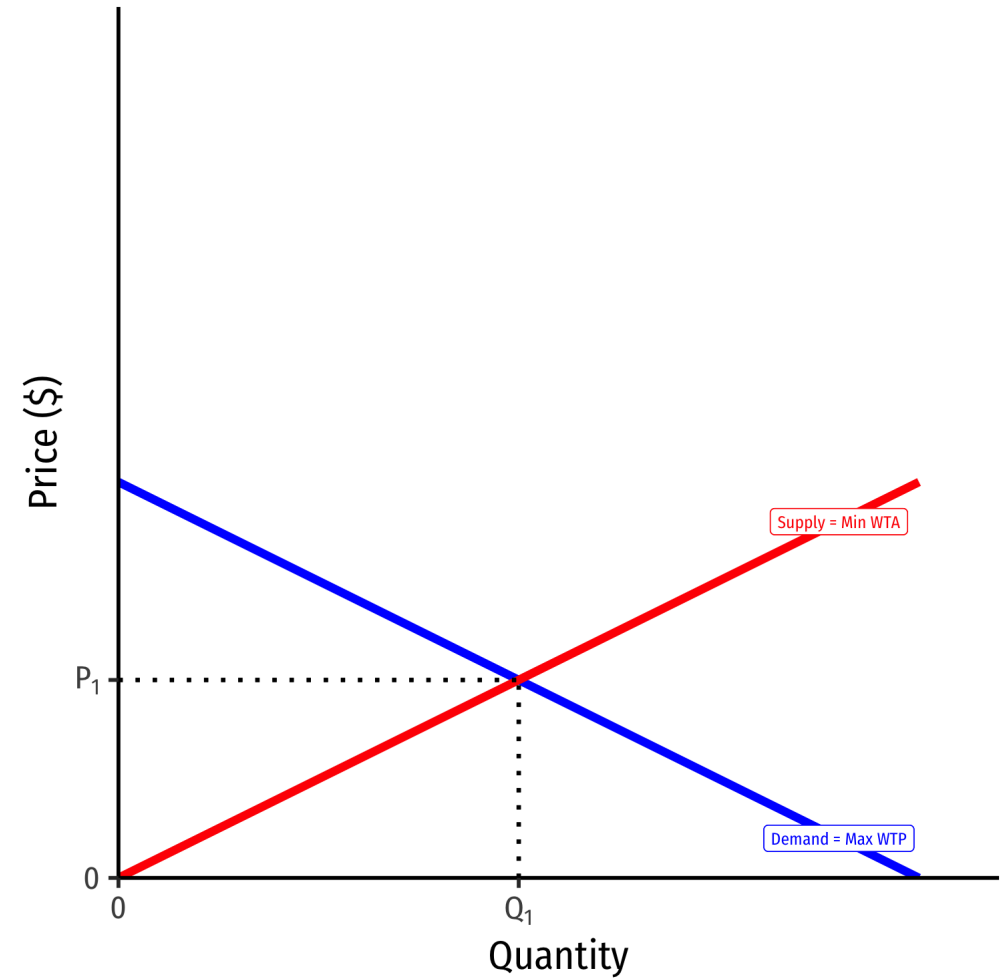
The toilet paper aisle of my Giant grocery store, March 2020

- Where did all of the ... go?
  - Toilet paper
  - Hand sanitizer
  - Masks
  - PPE
  - Ventilators
- Three major issues:
  - price elasticity of supply
  - price gouging laws
  - restrictions & regulations on supply

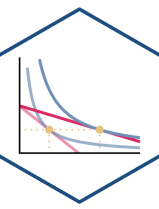
# Increase in Demand



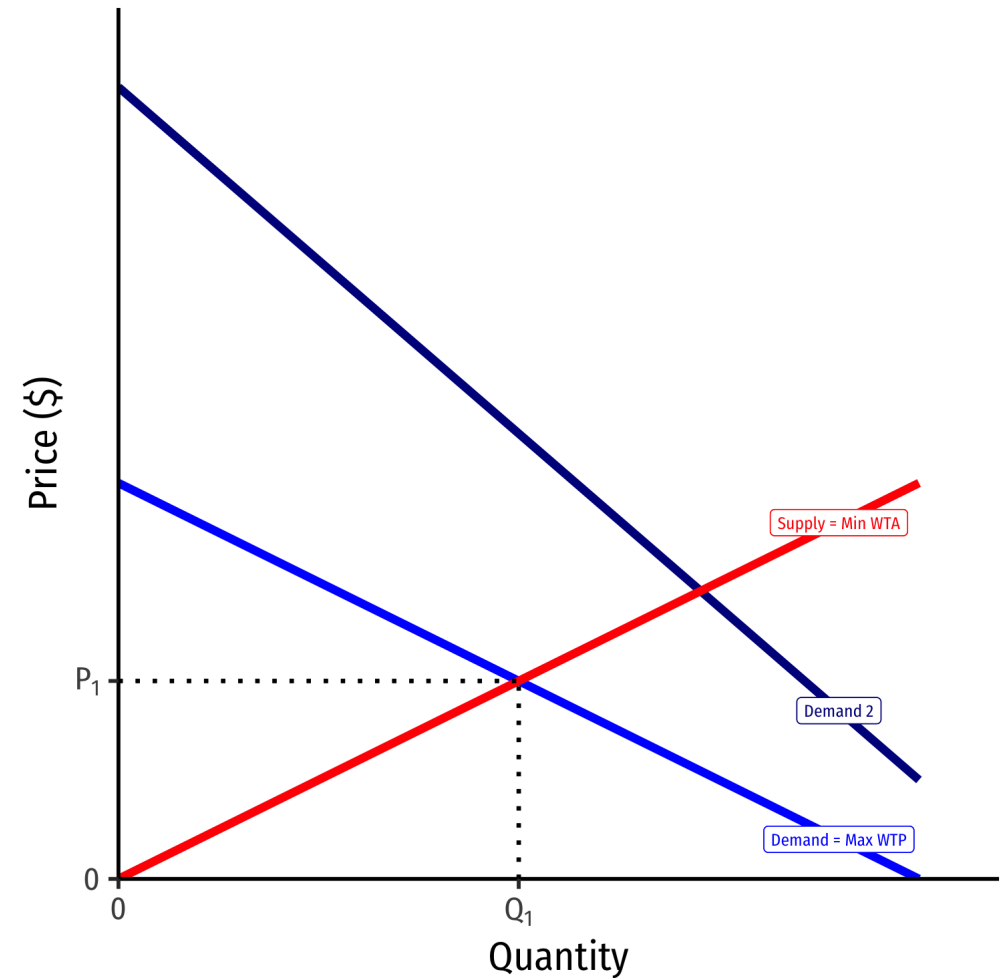
- Consider a market for a good in equilibrium,  $P_1$



# Increase in Demand



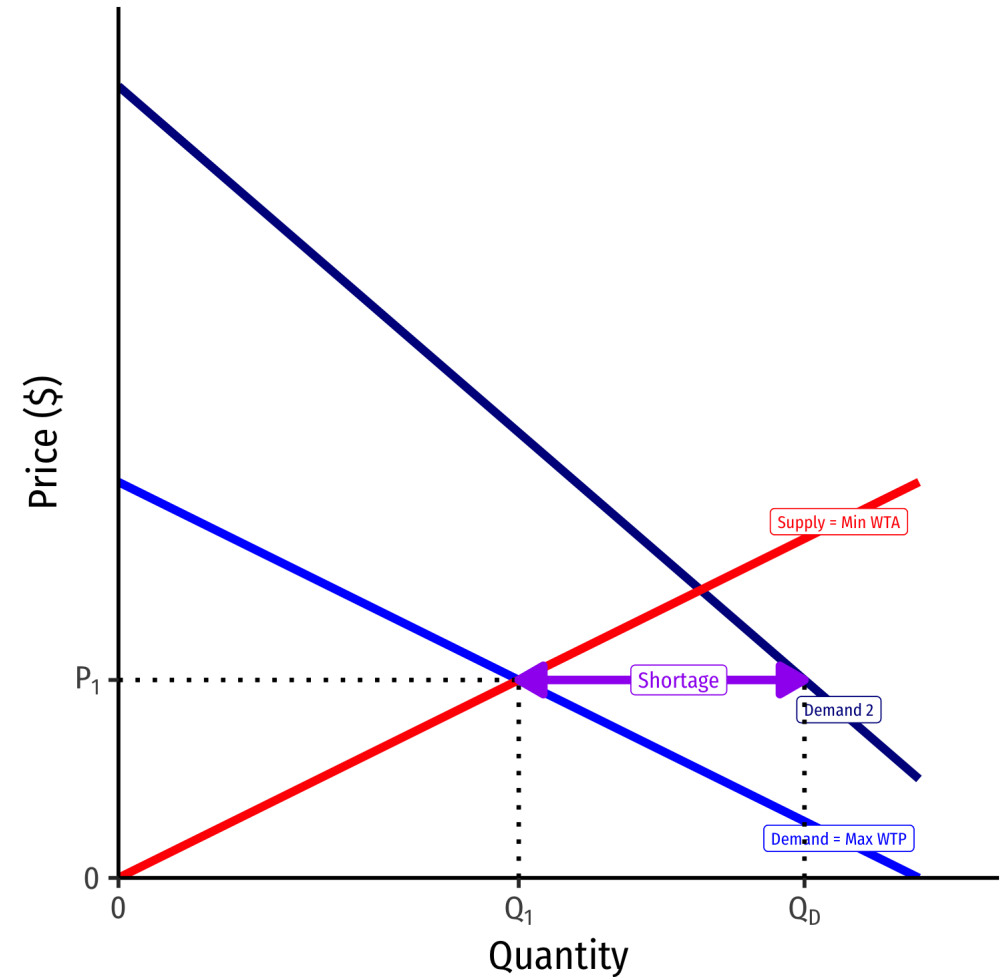
- More individuals want to buy more of the good at *every* price
- Demand *increases*, becomes *less elastic*



# Increase in Demand



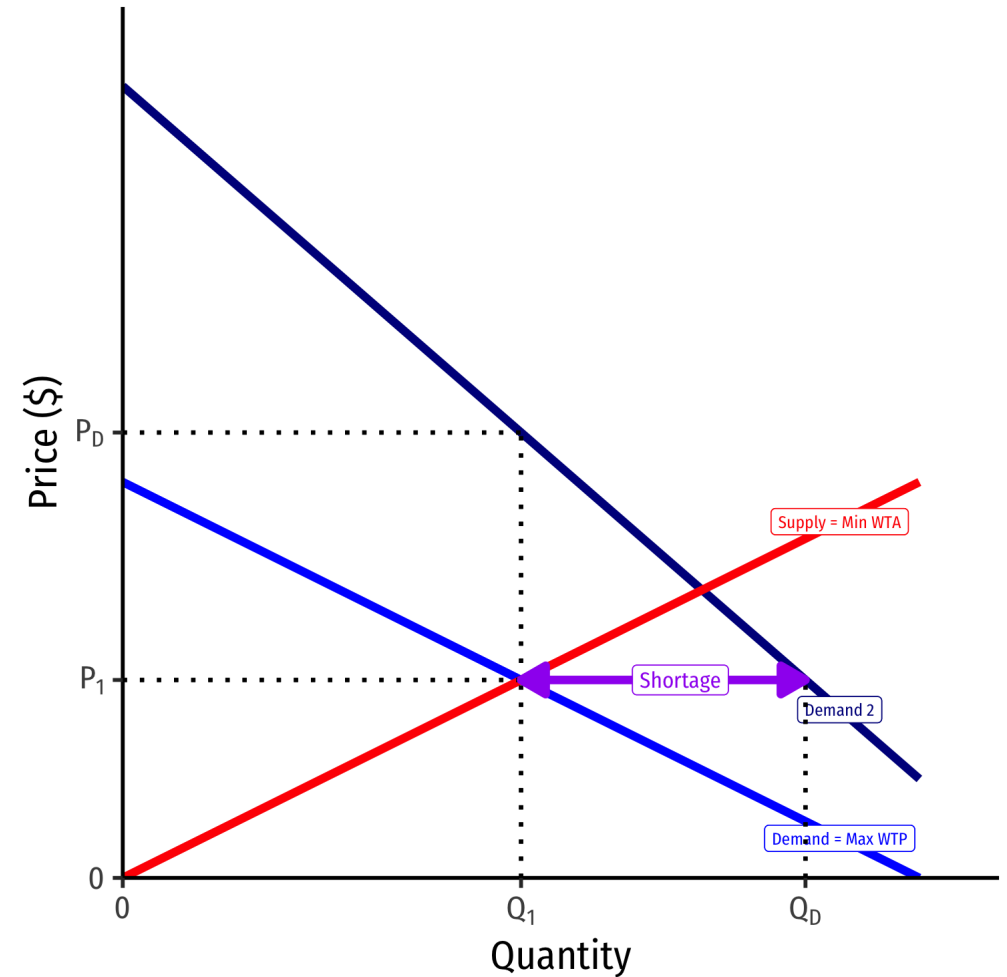
- More individuals want to buy more of the good at *every* price
- Demand *increases*, becomes *less elastic*
- At the original market price, a **shortage!**  
( $q_D > q_S$ )



# Increase in Demand



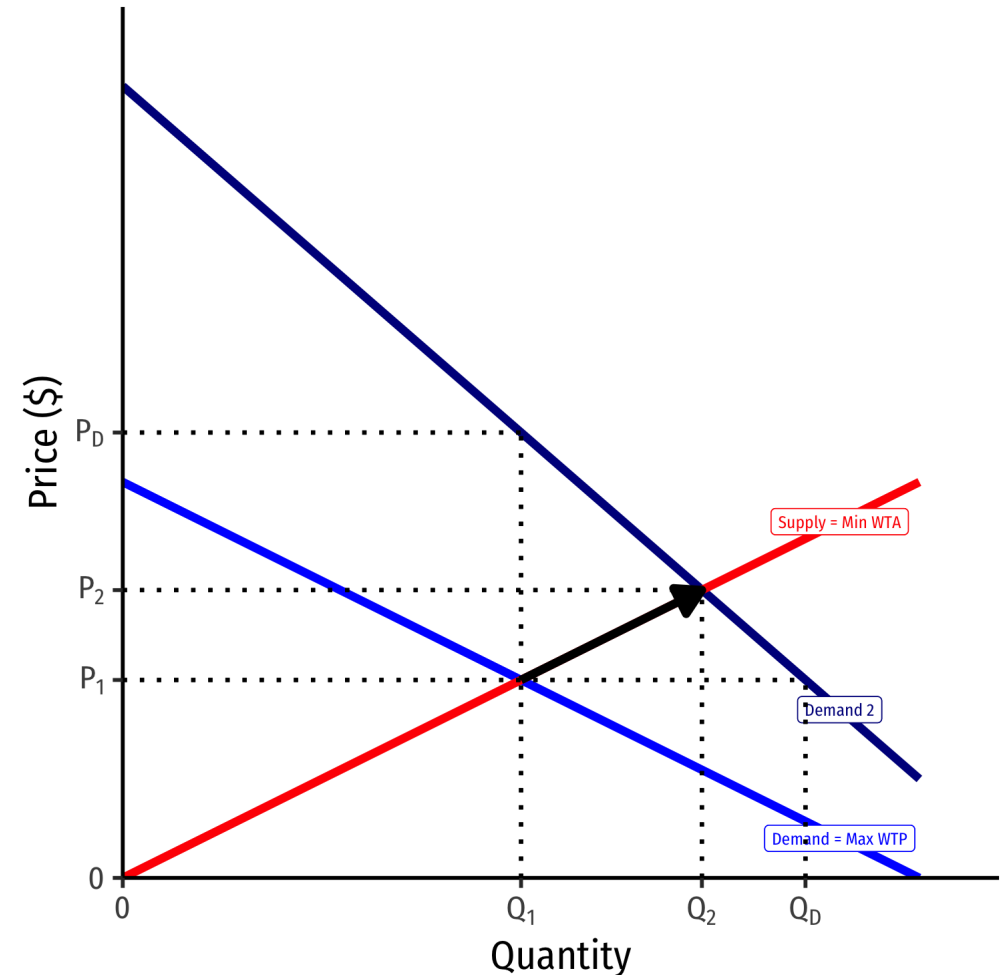
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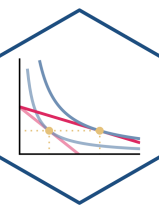
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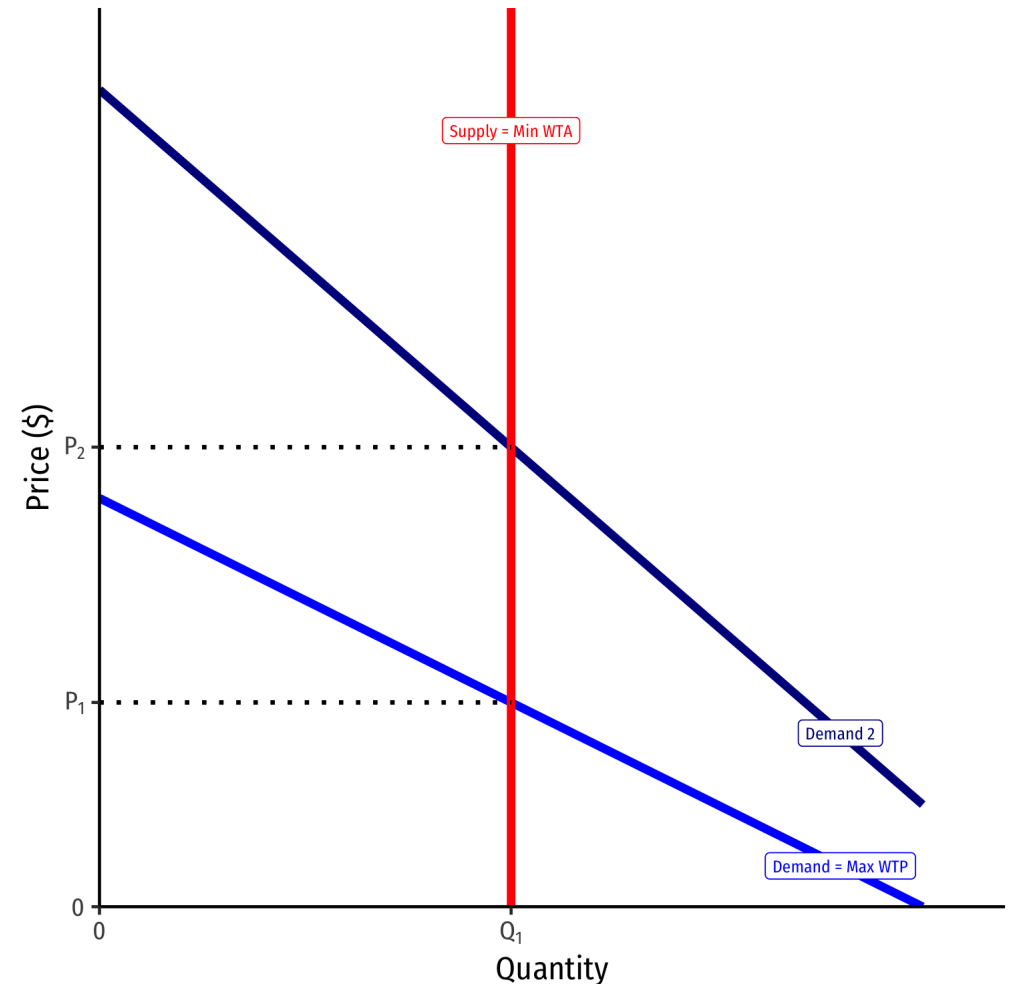
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- **Sellers** are supplying  $Q_1$ , but some **buyers** willing to pay more for  $Q_1$
- **Buyers** raise bids, inducing **sellers** to sell more
- Reach new equilibrium with:
  - **higher market-clearing price** ( $P_2$ )
  - **larger market-clearing q. exchanged** ( $Q_2$ )



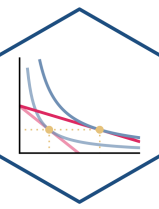
# One Possibility: Inelastic Supply



- It might that **supply** is very *inelastic*
  - Here: *perfectly* inelastic (for convenience)
- Suppliers can't produce and sell more units even if they want to at very high price demanded
  - sudden shock to inventories (short run)
  - rising production costs
  - government regulations & restrictions
- Thus, the new high price is an equilibrium that will persist for a while
  - no "inefficiency," just a fixed supply of goods we cannot easily change



# One Possibility: Inelastic Supply



**flexport.** [Get Started](#)

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APR. 14, 2020

## Why There Aren't Enough Masks, and How to Get More

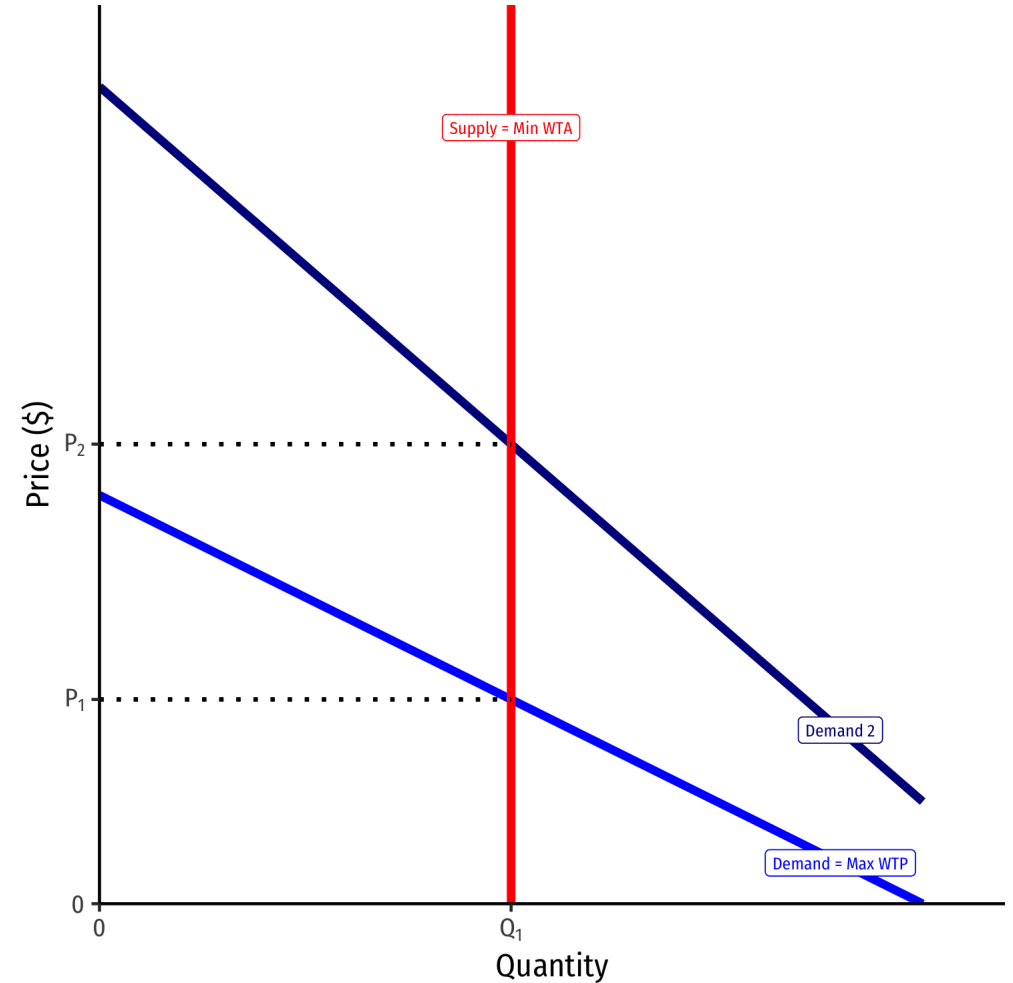
Tags: Coronavirus, Freight Forwarding

Ryan Petersen, Flexport Founder and CEO  
Flexport CEO

American hospitals are disastrously short of masks and other personal protective equipment (PPE), and demand will only increase. They estimate they will need 20x their ordinary supply over the next few months. In its current form, our supply chain cannot handle this demand shock.

In this blog post, I'll share my view of how this problem happened, and explore some ideas for how we can better serve our healthcare workers.

The current shortage of PPE is not due to a single cause. It has at least five components: insufficient inventory stockpiles, manufacturing capacity and quality control, international trade compliance, air uplift capacity, and working capital financing. And if we don't plan ahead, we'll have a sixth

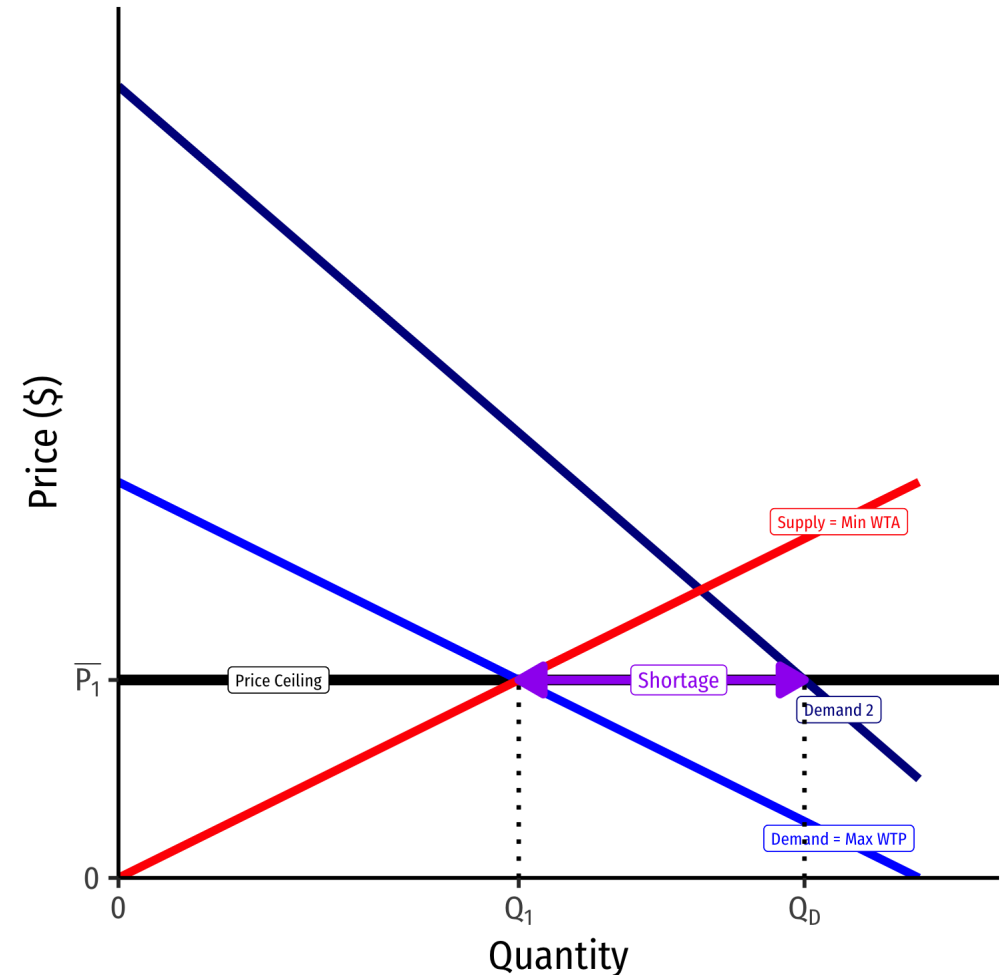




# Price Gouging Laws



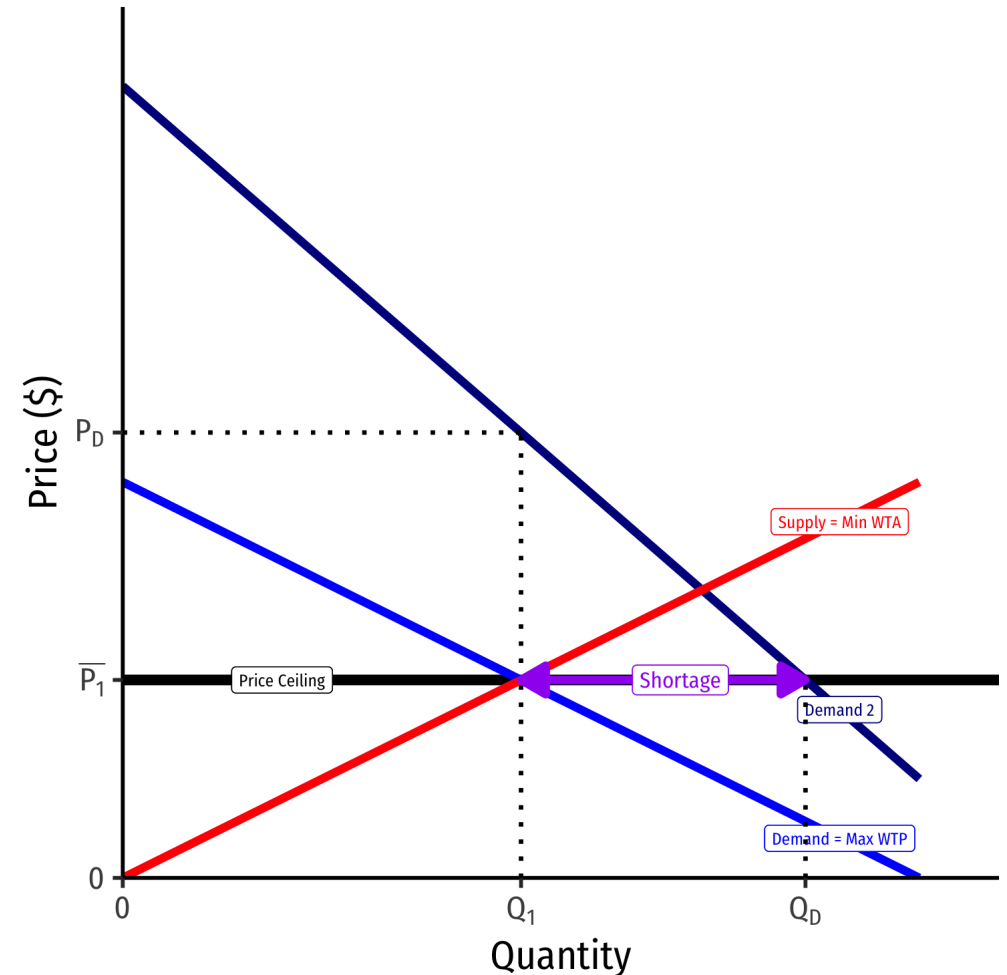
- Additionally, government has **anti-price-gouging laws**, a **price ceiling** at the original price,  $P_1$
- $Q_d > Q_s$ : **excess demand**, a **shortage**!
- Sellers will not supply more than  $Q_1$  at price  $\bar{P}_1$



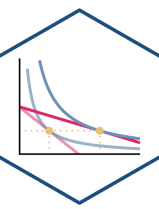
# Price Gouging Laws



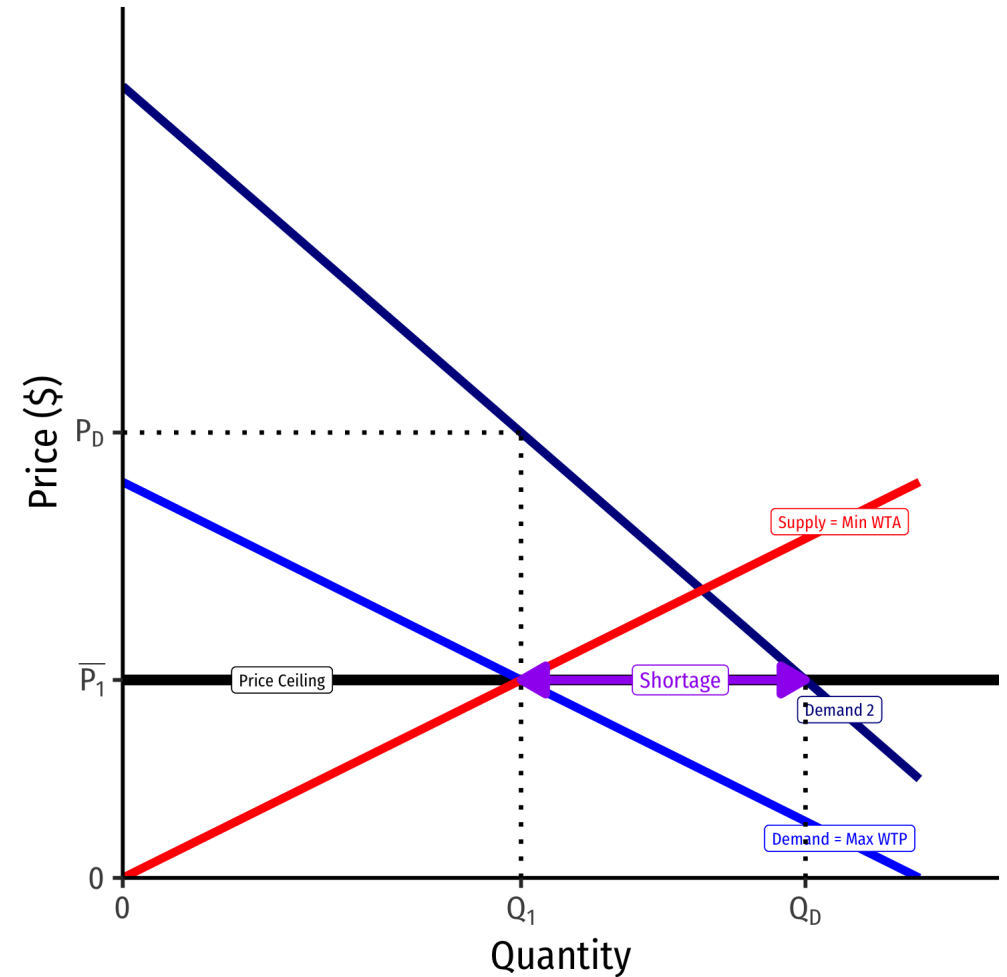
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- $Q_d > Q_s$ : **excess demand**, a **shortage**!
- Sellers will not supply more than  $Q_1$  at price  $\bar{P}_1$
- For  $Q_1$  units, buyers are willing to pay  $P_D$ !



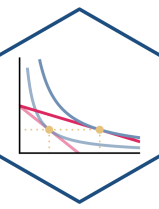
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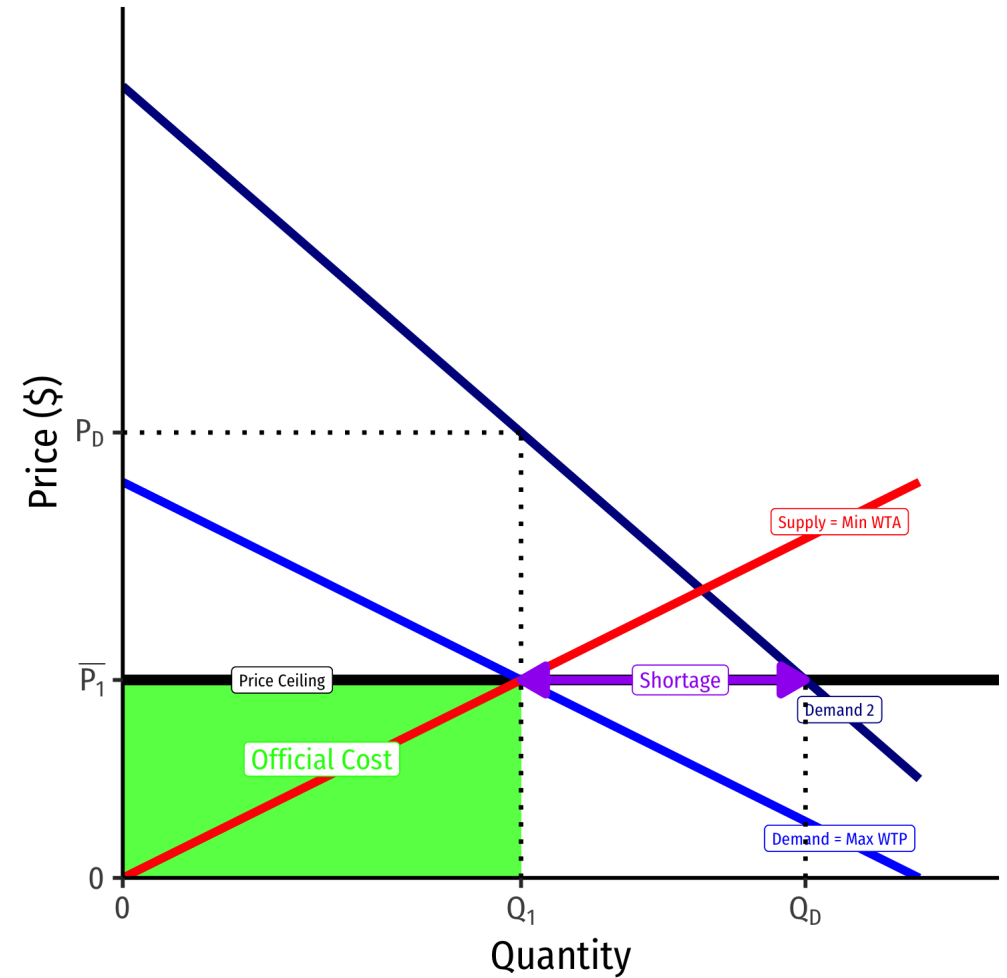
- **If prices were allowed to adjust:** buyers would bid higher prices to get the scarce  $Q_s$  goods
- Sellers would respond to rising willingness to pay, and produce and sell more
- **But the price is not allowed to rise above  $\bar{P}_1$ !**



# Price Gouging Laws



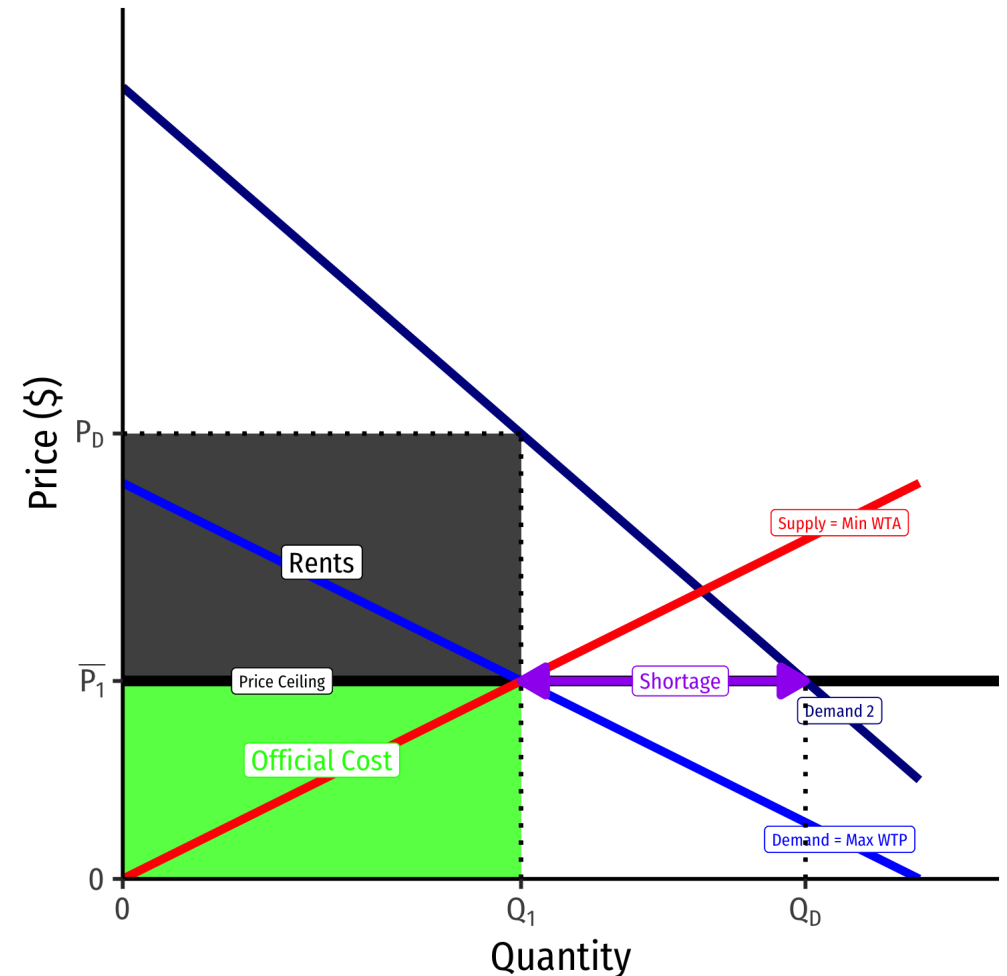
- Official price is  $\bar{P}_1$ , sellers gain **monetary revenues**



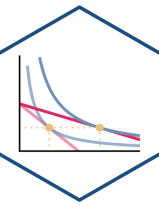
# Price Gouging Laws



- Official price is  $\bar{P}_1$ , sellers gain **monetary revenues**
- Competition exists between buyers to obtain scarce  $Q_s$  goods
  - Buyers willing to pay  $P_D$  *unofficially*
- Goods are distributed by non-market means:
  - Queuing
  - Black markets
  - Political connections, favors, corruption
- **Economic rents:** excess returns (above opp. cost) to those who own the scarce goods



# Forms of Rents



nytimes.com

The New York Times



An Amazon merchant, Matt Colvin, with an overflow stock of cleaning and sanitizing supplies in his garage in Hixson, Tenn. Doug Strickland for The New York Times

## *He Has 17,700 Bottles of Hand Sanitizer and Nowhere to Sell Them*


Amazon cracked down on coronavirus price gouging. Now, while the rest of the world searches, some sellers are holding stockpiles of sanitizer and masks.

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washingtonpost.com

## Day-to-day, line-to-line

In the South Bronx, coronavirus life now is waiting, and waiting, for anything and everything

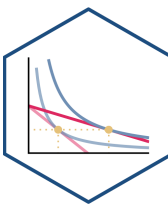


People wait outside the Citibank on the corner of East 149th Street and Courtlandt Avenue in the South Bronx. Current social distancing rules in New York require patrons to line up six feet apart and wear masks. (Photos by Demetrius Freeman for The Washington Post)

By [Stephanie McCrummen](#)

APRIL 26, 2020

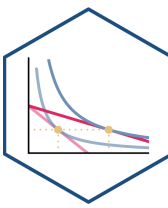
# (Temporarily) Raising Prices Can Solve the Shortage



A relatively high price:

- **Conveys information:** good is relatively scarce
- **Creates incentives for:**
  - **Buyers:** conserve use of this good, seek substitutes
  - **Sellers:** produce more of this good
  - **Entrepreneurs:** find substitutes and innovations to satisfy this unmet need

# (Temporarily) Raising Prices Can Solve the Shortage



AIER | AMERICAN INSTITUTE for ECONOMIC RESEARCH

## Why No Shortages in Canada as Compared with the U.S.?

Home >> Daily Economy >> Crisis, Economic Trends, International

Raymond C. Niles – April 22, 2020

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**B**ecause of the shutdown of my college campus, students in the three economics

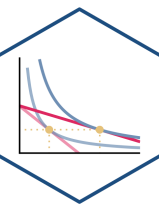
<https://www.aier.org/article/united-states-needs-freedom-not-fascism/>

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"The *Canadian National Post*, citing the Canadian Food Inspection Agency, says that 'There are no shortages or disruptions to [food] production, importation or export,' and that 'the shelves remain stocked.' ... 'A price surge as a result of natural market forces is not something that is regulated by Canadian competition laws or otherwise. Canada's competition laws generally don't interfere with the free market.' ... Canadians will have enough food to eat. But it will be more expensive.



# (Temporarily) Raising Prices Can Solve the Shortage



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A supermarket in Denmark got tired of people hoarding hand sanitizer, so came up with their own way of stopping it.

1 bottle kr40 (€5.50)

2 bottles kr1000 (€134.00) each bottle.

Hoarding stopped!

[#COVID19](#) [#Hoarding](#) [pic.twitter.com/eKTabEjScc](https://pic.twitter.com/eKTabEjScc) (via [@\\_schuermann](#)) cc [@svenseele](#)

2:28 AM · Mar 18, 2020



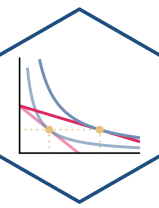
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See the latest COVID-19 information on Twitter

[Read 56 replies](#)

# Supply-Side Restrictions & Regulatory Burden



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IDEAS

## Unlicensed Haircuts Are Only the Beginning

Amid a pandemic, states are cutting back the red tape that kept health-care workers out.

APRIL 15, 2020

**Paul Sherman**  
Attorney at the Institute for Justice

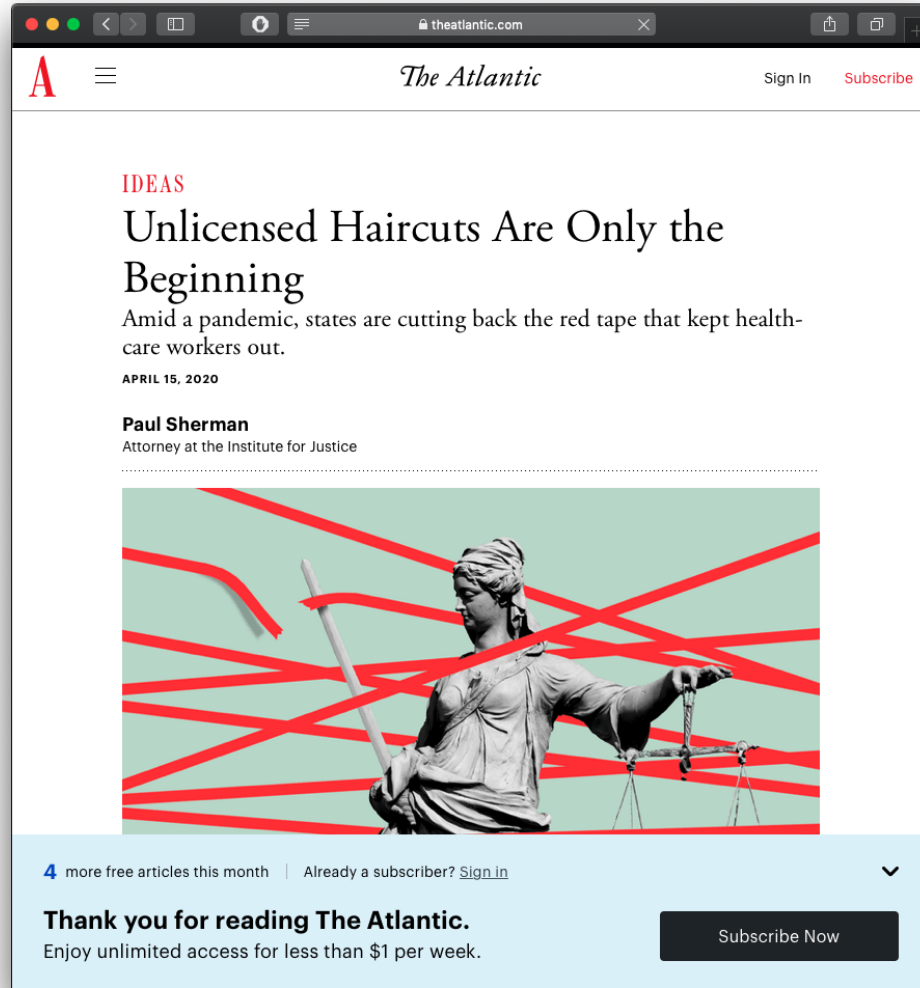
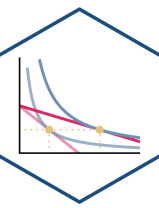
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"As the nation's economy and health-care system struggle to adjust to the pandemic, more and more states are reexamining some of their oldest occupational and business regulations—rules that, although couched as protecting consumers, do far more to limit competition...While some states have ordered their occupational-licensing boards to speed up the licensure of new health-care practitioners, others...are granting immediate licensing reciprocity to any practitioner licensed in any state...Even Florida, which has long jealously guarded its occupational-licensing regime to prevent semiretired snowbirds from poaching on the locals' turf, [is] allowing out-of-state health-care providers to practice telemedicine in the state without a license."

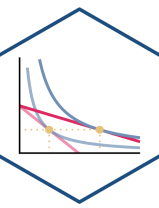
# Supply-Side Restrictions & Regulatory Burden



The screenshot shows a browser window with the URL [theatlantic.com](https://theatlantic.com). The page header includes the Atlantic logo, a menu icon, the text "The Atlantic", and links for "Sign In" and "Subscribe". The article is categorized under "IDEAS" and has the title "Unlicensed Haircuts Are Only the Beginning". The sub-headline reads "Amid a pandemic, states are cutting back the red tape that kept health-care workers out." The date is "APRIL 15, 2020" and the author is "Paul Sherman, Attorney at the Institute for Justice". The main image features a statue of Lady Justice with scales and a sword, overlaid with several thick red diagonal lines. At the bottom of the browser window, there is a promotional banner that says "4 more free articles this month | Already a subscriber? [Sign in](#)" and a "Subscribe Now" button.

"Illinois has waived licensure fees for retired medical practitioners who wish to resume practice. Oklahoma and Massachusetts have eliminated restrictions that required doctors to have a preexisting doctor-patient relationship before they could offer telemedicine services."

# Supply-Side Restrictions & Regulatory Burden



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IDEAS

## Unlicensed Haircuts Are Only the Beginning

Amid a pandemic, states are cutting back the red tape that kept health-care workers out.

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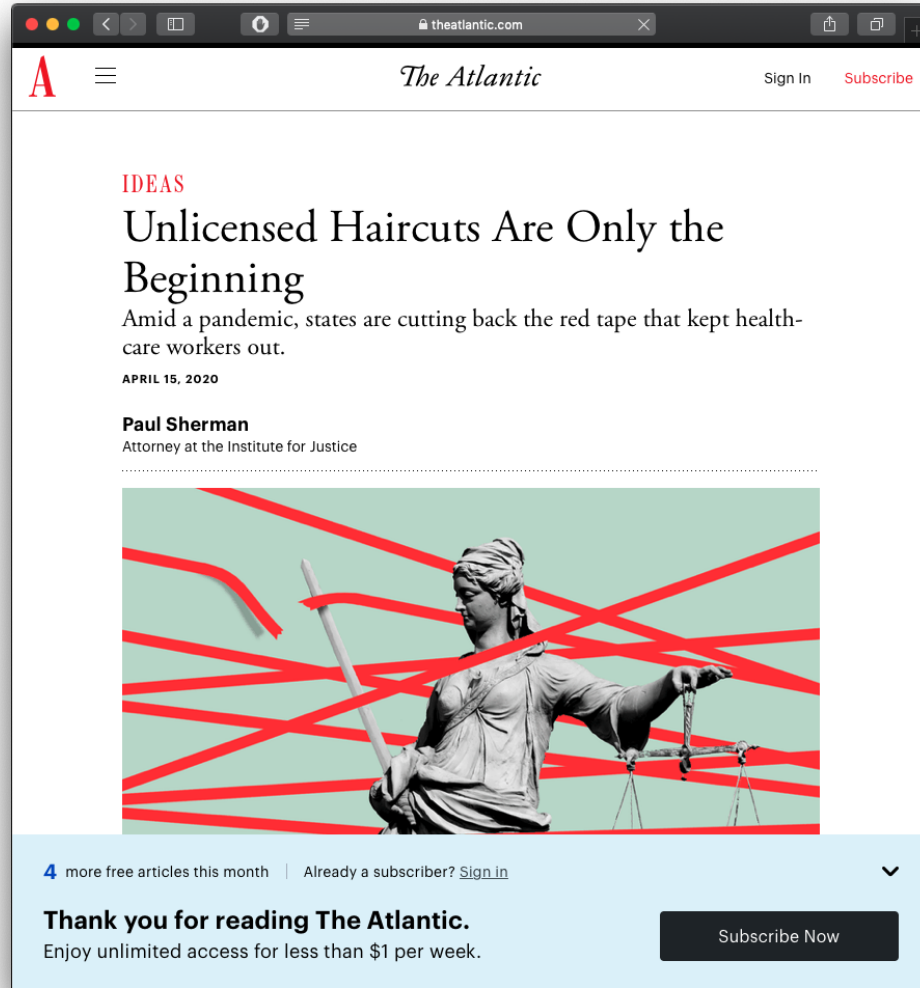
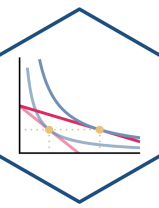
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"Also being reexamined are state certificate-of-need, or CON, laws. A product of 1970s-era economic regulation, CON laws require health-care providers to prove that new services are "needed" before they may purchase certain large equipment, open new or expanded facilities, or—as is crucial now—offer home health-care services. Often, these laws give an effective veto power to existing medical providers, allowing them to torpedo new competition for their own benefit...Basic economics predicts that competition reduces prices for consumers, and occupational licensing works directly to stifle competition."

# Supply-Side Restrictions & Regulatory Burden



The Atlantic


IDEAS

## Unlicensed Haircuts Are Only the Beginning

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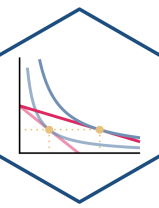
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"The University of Minnesota economist Morris Kleiner, a leading researcher on occupational licensing, estimates that licensing costs consumers nearly \$200 billion annually. This might be justifiable if licensing produced substantial improvements in quality, yet most research has failed to find a connection between licensure and service quality or safety."

# Supply-Side Restrictions & Regulatory Burden





reason

CORONAVIRUS

## FDA Will Lift Restrictions on Face Mask Imports, Toppling Another Pointless Regulation

Health care workers will now be allowed to use the Chinese-certified KN95 masks, which are equivalent to the N95 masks that are in short supply.

ERIC BOEHM | 4.3.2020 4:40 PM



Workers produce KN95 face masks at a mask factory of 3M in Shanghai. (Ren Long Xinhua News Agency/Newscom)

After facing criticism for its policies that limited the availability of critically needed face masks, the Food and Drug Administration (FDA) now says it will allow KN95 masks to be bought by hospitals and used by health care workers.

The KN95 designation is a Chinese government standard that is widely considered to be equivalent to the N95 masks approved by American regulators. Guidance issued by the Centers for Disease Control (CDC) says the KN95 masks are "suitable alternatives" to the N95 mask when medical supplies are running short, and research from Minnesota-based 3M Corporation [found](#) that KN95 masks are "reasonable to consider....as equivalent" to the N95 variety.



reason

CORONAVIRUS

## L.A. Bureaucrats Shut Down Restaurants for Selling Groceries Without a Permit

"You cannot just decide you want to sell groceries," said Barbara Ferrer, the director of L.A. County Public Health.

BILLY BINION | 3.31.2020 4:35 PM



(ID 95119477 © Jacqueline Nix | Dreamstime.com)

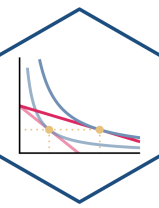
A few Los Angeles restaurants struggling to maintain footing amid the COVID-19 outbreak identified a clever way to generate revenue while still serving the community: Start selling groceries.

The city's public health department promptly shut them down. The reason? The small businesses don't have a "grocery permit."

"It's not really possible for a restaurant to become a grocery store," Dr. Barbara Ferrer, director of Los Angeles County Public Health, said in a briefing yesterday. "You cannot just decide you want to sell groceries."

Why anyone can't do exactly that—exchange goods with those who want to purchase them—remains a mystery. Such licensing laws are typically put in

# Supply-Side Restrictions & Regulatory Burden




reason

CORONAVIRUS

## America Could Import Countless More Face Masks if Federal Regulators Would Get Out of the Way

Markets are trying to meet spiking demand for face masks, but importers are stymied by the FDA and CDC

ERIC BOEHM | 3.31.2020 4:20 PM



(Carlos Tischler / Eyepix Group/Newscom)

Despite spending the past few weeks assuring Americans that wearing a face mask in public is not necessary to stop the spread of COVID-19, the Centers for Disease Control (CDC) is reportedly reconsidering that stance.

According to *The New York Times*, the [CDC is mulling changes](#) to its guidelines for who should be wearing face masks due to evidence that the COVID-19 outbreak is being spread largely by people lacking symptoms of the disease. There is also mounting circumstantial evidence that countries where mask-wearing is more of a cultural norm have had greater success in containing the disease's spread.

FEE

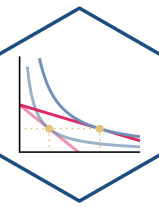
## A Look at the FDA's Process for Approving Surgical Masks

To save lives, we need to cut back on regulations and red tape that make it harder to fight the virus.

Friday, April 10, 2020



# Supply-Side Restrictions & Regulatory Burden



NEWS NBC NEWS NOW NIGHTLY NEWS MEET THE PRESS DATELINE

**NBC NEWS** SHARE THIS - f t e ...

## Many private labs want to do coronavirus tests. But they're still facing obstacles and delays.

"I could have tested over 1,000 patients by now instead of checking boxes," said the director of a North Carolina lab.

reason

CORONAVIRUS

## U.S. Needs Billions of New Masks to Combat Coronavirus. Feds Say It'll Take Up To 90 Days to Approve New Mask-Making Facilities.

Established makers of N95 masks are ramping up production as fast as they can. New manufacturers hoping to help meet demand are running into regulatory roadblocks.

CHRISTIAN BRITSCHGI | 3.24.2020 2:45 PM

f t e

(Chabko/Dreamstime.com)

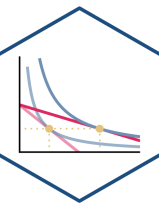
America is suffering from a shortage of almost everything it needs to combat the spread of COVID-19. Hospital beds, ventilators, gloves, and gowns are all in short supply.

That's particularly true of the N95 masks that help medical professionals avoid catching and spreading the virus as they tend to patients. The N95 designation refers to the ability of these masks to filter out 95 percent of airborne particles.

In early March, the U.S. Department of Health and Human Services (HHS) said that the country's stockpile of N95 masks was enough to meet about 1 percent



# Supply-Side Restrictions & Regulatory Burden



THE DISPATCH Join

## Timeline: The Regulations—and Regulators—that Delayed Coronavirus Testing

There have been three major regulatory barriers so far.

Alec Stapp Mar 20 62 98

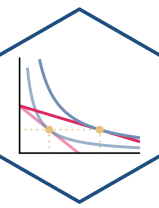


Addressing the media alongside the coronavirus task force on Thursday, Donald Trump said he would “slash red tape like nobody has even done it before” to get approval for coronavirus treatments.

Open "https://cdn.substack.com/image/etch/c\_limit,f\_auto,q\_auto:good/https...2F93887c23-5370-43db-a29b-b439674d1102\_1024x683.jpeg" in a new tab

How did the U.S. government only manage to produce a fraction as many testing kits as its peer countries? There have been three major regulatory barriers so far to scaling up testing by public labs and private companies: 1) obtaining an Emergency Use Authorization (EUA); 2) being certified to perform high-complexity testing consistent with requirements under Clinical Laboratory Improvement Amendments (CLIA);...

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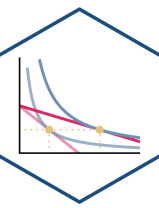


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...and 3) complying with the Health Insurance Portability and Accountability Act (HIPAA) Privacy Rule and the Common Rule related to the protection of human research subjects. On the demand side, narrow restrictions on who qualified for testing prevented the U.S. from adequately using what capacity it did have.

# Supply-Side Restrictions & Regulatory Burden



**Skip Tognetti** 🍷  
@togmeter · [Follow](#)



Honestly, I'm not sure people completely understand how small distilleries, generally with VERY little capital on hand, are changing their business models in just a week. We appreciate the outpouring of love. We're working like crazy to get what we need to make more sanitizer.

12:40 PM · Mar 25, 2020 from Seattle, WA



[Read the full conversation on Twitter](#)



511



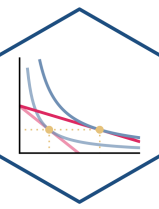
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# Supply-Side Restrictions & Regulatory Burden



**Skip Tognetti** 🍷 · Mar 25, 2020



@togner · [Follow](#)

Replying to @togner

Meanwhile, we're being required to denature the alcohol to make it not drinkable...so that it doesn't get TAXED AS AN ALCOHOLIC BEVERAGE, just in case you wanted to drink a 160-proof ethanol/glycerin/hydrogen peroxide cocktail. But denaturing agents are nearly impossible to find.



**Skip Tognetti** 🍷

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There is literally no medical reason to denature. Taxation. That's it.

In WA, that means if I sell a liter for \$10, which I'm barely covering my costs on, the tax owed between state and federal governments is EIGHT DOLLARS AND TWENTY THREE CENTS.

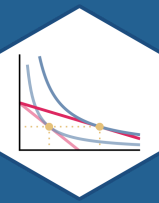
And yet...

12:40 PM · Mar 25, 2020 from Seattle, WA



♥ 173    Reply    Copy link

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# Making Fair Comparisons

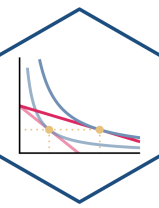
# Government Failure & Market Failure



- We've talked about **market failure** under certain conditions
- However there is also **government failure**
  - corruption, rent-seeking, voter ignorance, voter irrationality, special interest groups, regulatory capture
- So stop comparing *ideal* institutions in theory and see how *they work in practice*
- Learn more in my [Public Economics](#) course



# Economic Theory *Assumes* Good Institutions



- Markets & price theory: how consumers & producers specialize, produce, & exchange within **given, well-functioning markets (& politics)**
- **Assumes** existence of "good" economic & political institutions that facilitate market exchange
  - low transaction costs
  - clear and enforced property rights
  - rule of law
  - contract enforcement
  - capable, high-capacity, non-corrupt government
  - dispute resolution



# Two Fundamental Problems of Political Economy



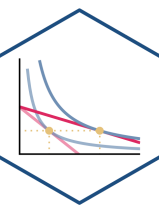
- All societies face two fundamental problems, which institutions emerge (or are created) to address:

**The Knowledge Problem:** How to coordinate the *tacit, fragmented* knowledge of opportunities and conditions *dispersed* across millions of individuals (and accessible to none in total) in order to maximize the ability of individuals to achieve their goals

**The Incentives Problem:** How to structure incentives that individuals face in a way that maximizes cooperative behavior (voluntary exchange and association) and minimizes non-cooperative behavior (cheating, opportunism, exploitation, violence, rent-seeking)



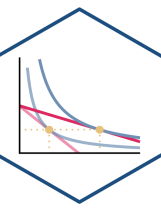
# Robust Political Economy



- **No system is perfect**
- We need to find arrangements that are **robust** to knowledge & incentive problems
- **Easy (unpersuasive) case**: perfect information & pure benevolence
  - every system works *in theory!*
- **Hard (persuasive) case**: uncertainty & selfish behavior
  - what works best *in practice?*
- Treat people as they are: sometimes good, bad, smart, stupid, opportunistic, altruistic, *depending on the institutions they face!*



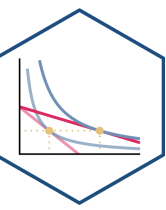
# Robust Political Economy



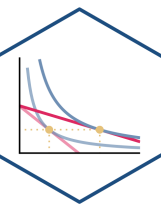
I THINK YOU SHOULD BE MORE SPECIFIC HERE IN STEP TWO



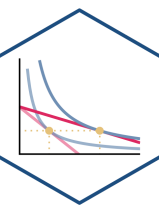
# A Bad Argument for Markets



# A Better, Comparative, Argument for Markets



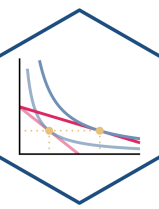
# Robust Political Economy



- People often recommend optimal policies as if they could be installed by a **benevolent dictator**
  - A dispassionate ruler with **total control**, **perfect information**, and **selfless incentives** to implement optimal policy
  - A “1<sup>st</sup>-best solution”
- In reality, 1<sup>st</sup>-best policies are distorted by the knowledge problem, the incentives problem, and politics
  - Real world: 2<sup>nd</sup>-to- $n^{\text{th}}$ -best outcomes



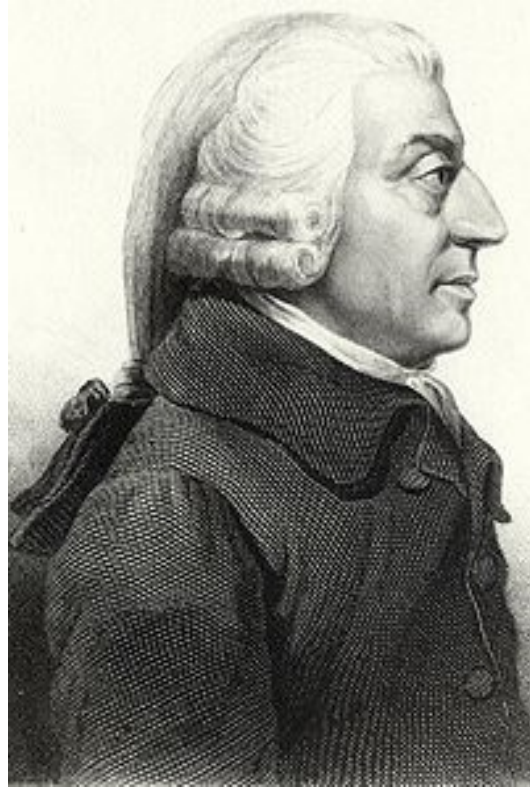
# Comparative Institutional Analysis



- Compare imperfections of *feasible* and *relevant alternative* systems
  - **The “Nirvana Fallacy”**: comparing an imperfect system in reality with an ideal system in theory
- Economics: *think on the margin!*
  - One system's “failure” does not automatically imply another will be “successful”!
  - Real world requires **tradeoffs**
  - “economics puts parameters on people's utopias”
  - “compared to what?”



# Institutions: Operationalizing Adam Smith



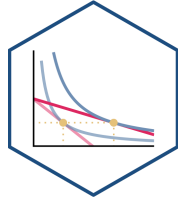
“[Though] he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention...By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it,” (Book IV, Chapter 2.9).

Smith, Adam, 1776, *An Enquiry into the Nature and Causes of the Wealth of Nations*

Adam Smith

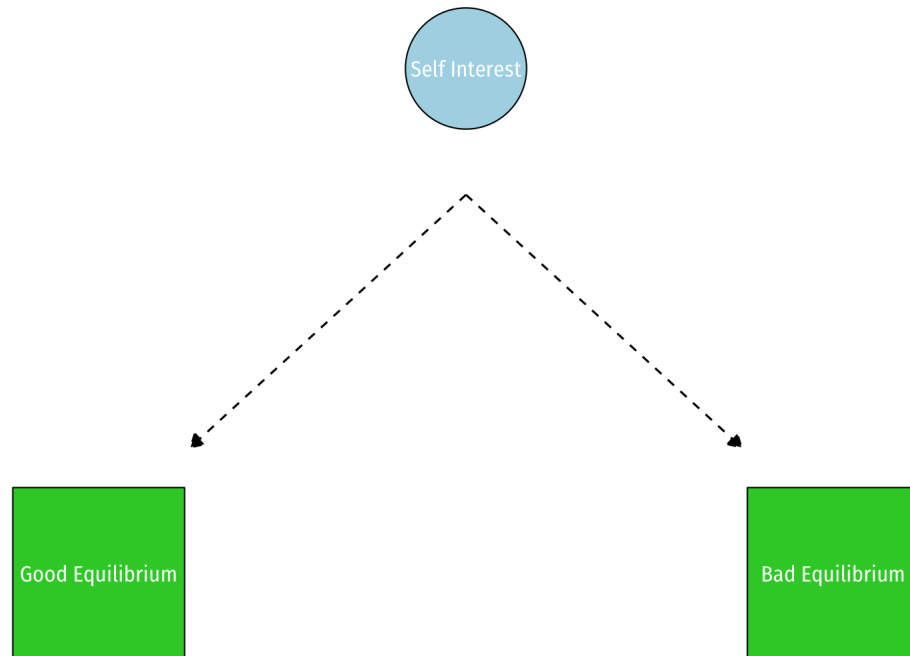
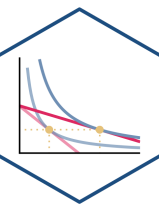
1723-1790

# Self-Interest Doesn't *Always* Benefit Society



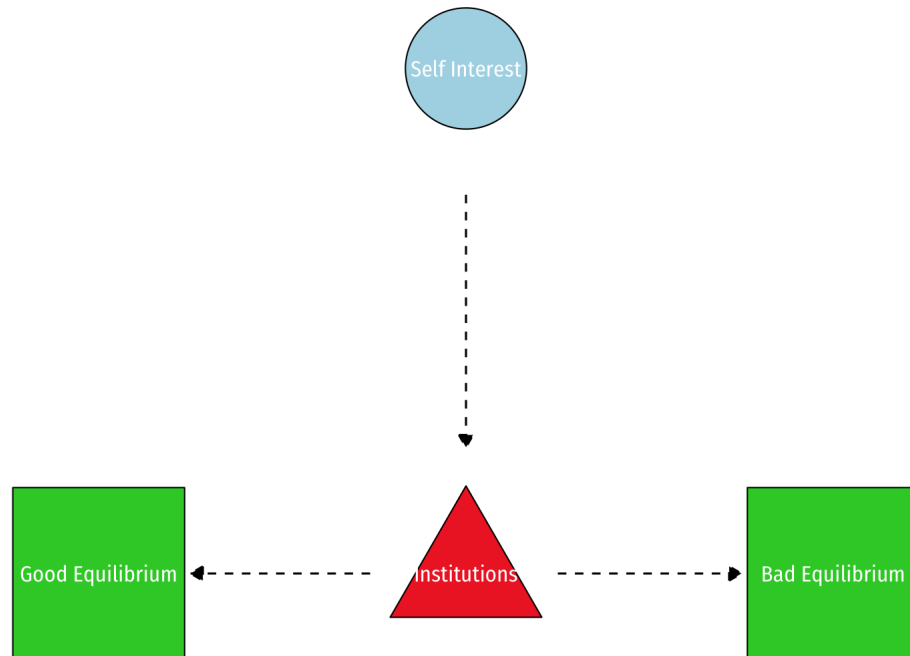
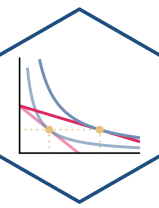


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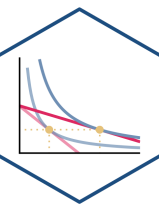
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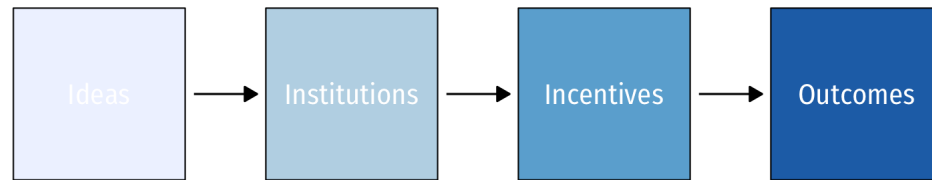
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# A Logical Framework for Political Economy

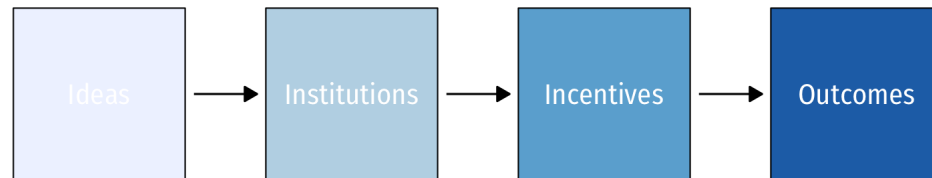
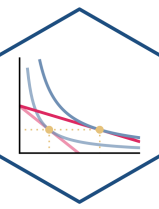


- **Outcomes:**

- relative level of wealth or poverty
- relative level of equality or inequality
- stability of politics, finance, macroeconomy



# A Logical Framework for Political Economy



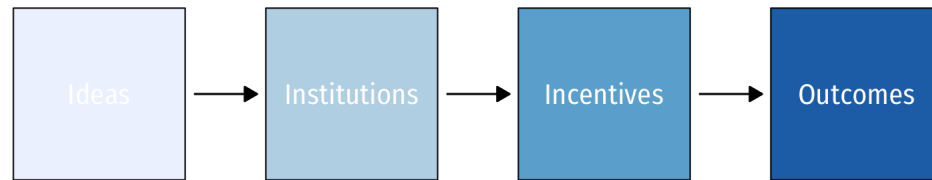
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- profits and losses
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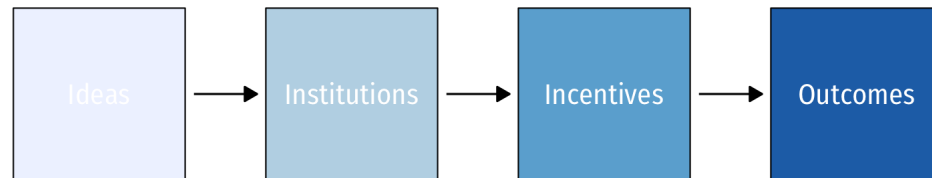
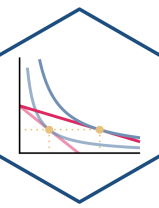
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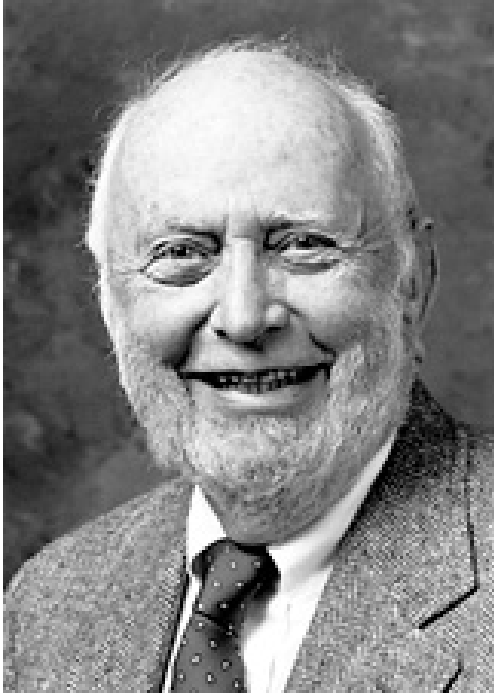
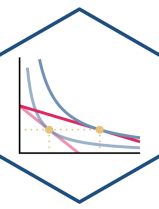
- allocation of rights, property, & power
- (in)equality before the law or corruption
- constraints on politics and economics

# A Logical Framework for Political Economy



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  - (in)equality before the law or corruption
  - constraints on politics and economics
- ...are determined by **Ideas:**
  - political and social worldview -"isms"
  - which groups (should) have status

# What are Institutions?



Douglass C. North

1920-2015

Economics Nobel 1993

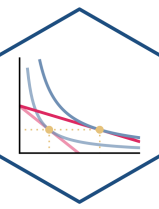
“Institutions are the humanly devised constraints that structure political economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights),”  
(p.10)

“Institutions are the rules of the game in a society,”  
(p.1).

North, Douglass C, (1991), "Institutions," *Journal of Economic Perspectives* 5(1): 97-112.

North, Douglass C, (1990), *Institutions, Institutional Change, and Economic Performance*

# Incentives are Structured by Institutions



“Who needs this nail?”

“Don't worry about it! The main thing is that we immediately fulfilled the plan for nails!”



# Institutions Channel Entrepreneurship



William Baumol

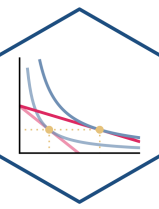
1922-2017

"If entrepreneurs are defined, simply, to be persons who are ingenious and creative in finding ways that add to their own wealth, power, and prestige, then it is to be expected that not all of them will be overly concerned with whether an activity that achieves these goals adds...to the social product," (pp.897-898).

"The rules of the game that determine the relative payoffs to different entrepreneurial activities do change dramatically from one time and place to another. Entrepreneurial behavior changes direction from one economy to another in a manner that corresponds to the variations in the rules of the game," (p.898).

Baumol, William J, (1990), "Entrepreneurship: Productive, Unproductive, and Destructive," *Journal of Political Economy* 98(5): 893-

# Profit Seeking and Rent Seeking



## **Productive entrepreneurship**

Profits from serving customers



## **Unproductive entrepreneurship**

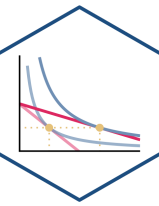
Rents from political  
privileges



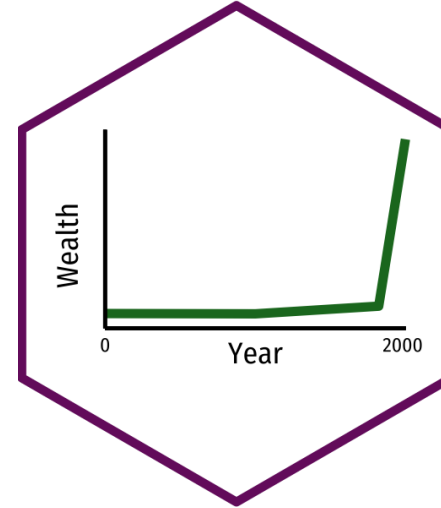
## **Destructive entrepreneurship**

Loot from theft and  
violence

# For More



ECON 410 – Public Economics

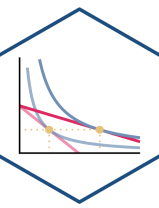


ECON 317 –  
Economics of  
Development



ECON 315 –  
Economics of the  
Law

# A Parting Note on Political Economy



Thomas Sowell

1972-

“The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”

“There are no solutions, there are only tradeoffs.”