

The Role of Institutions ...

... And the Crisis in Europe

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Economic Challenges of the XXI Century
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INSTITUTIONS

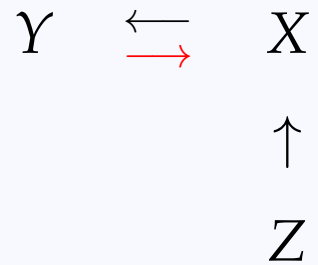
Douglas North's Nobel Prize Acceptance Speech

*Institutions are the humanly devised **constraints** that structure human interaction.*

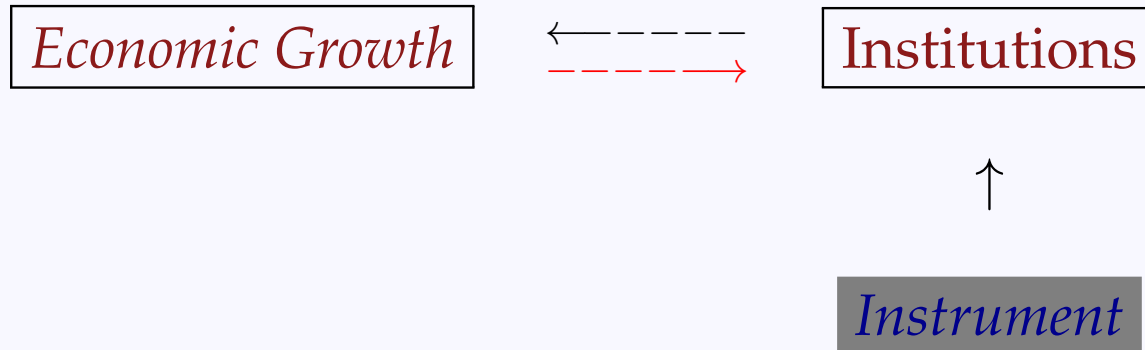
*They are made up of **formal** constraints (rules, laws, constitutions), **informal** constraints (norms of behaviour, conventions, and self imposed codes of conduct), and their enforcement characteristics.*

*Together they define the **incentive structure of societies** and specifically economies.*

ENDOGENEITY AND FEEDBACK LOOPS

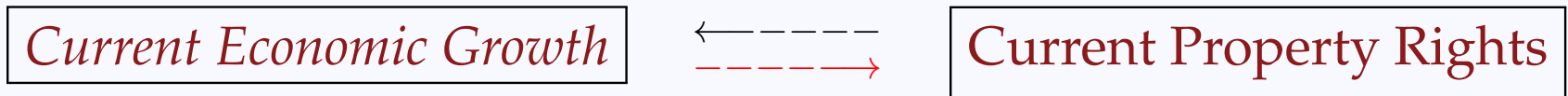


ENDOGENEITY AND FEEDBACK LOOPS



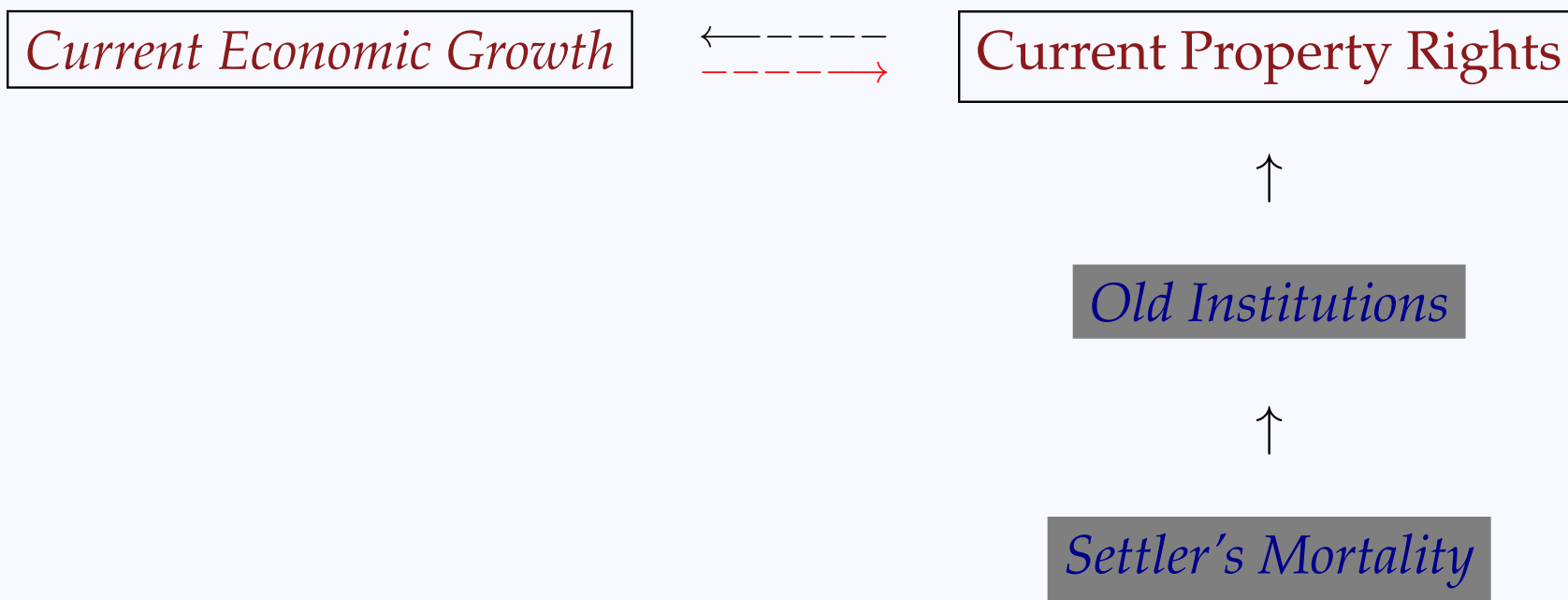
ECONOMIC GROWTH AND PROPERTY RIGHTS

Acemoglu (2001). The colonial origins of comparative development: An empirical investigation



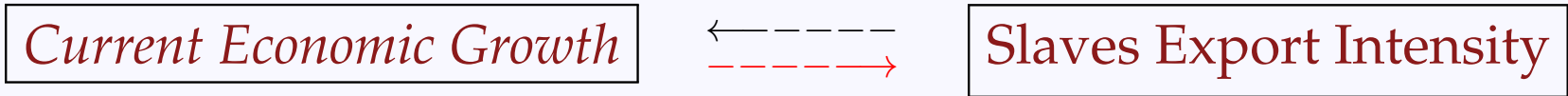
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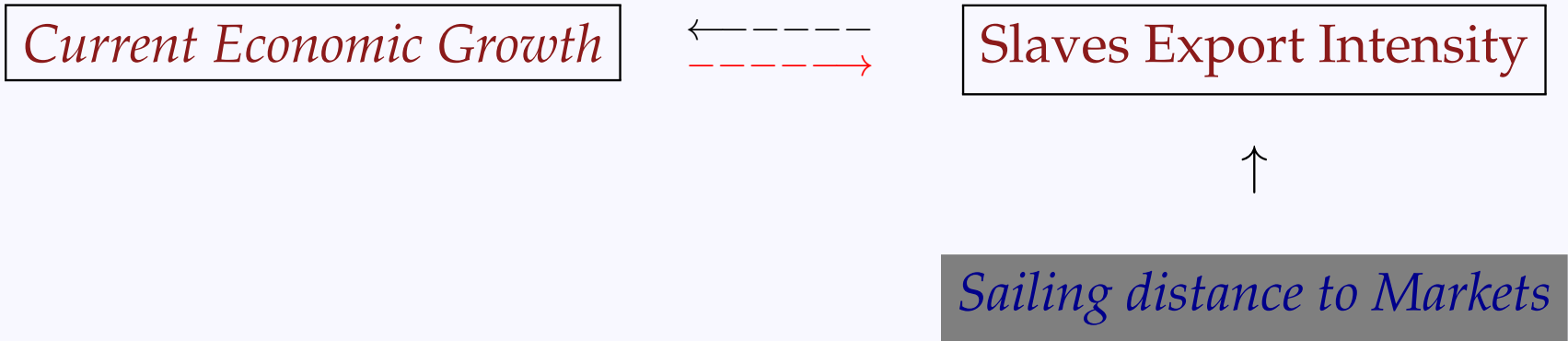
ECONOMIC GROWTH AND HISTORICAL SLAVE TRADE

Nunn (2008). The Long-Term Effects of Africa's Slave Trades



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SHOCKS TO THE ECONOMIC SYSTEM

Exogenous Shocks

- *Weather shocks*
- **Contagion:** *Virus in Hong Kong*

Endogenous Shocks

- *Financial crisis*
- **Contagion:** *Spreading through contact*

STRUCTURAL TRANSFORMATION

Quality Ladder

India ...

China ...

Brazil ...

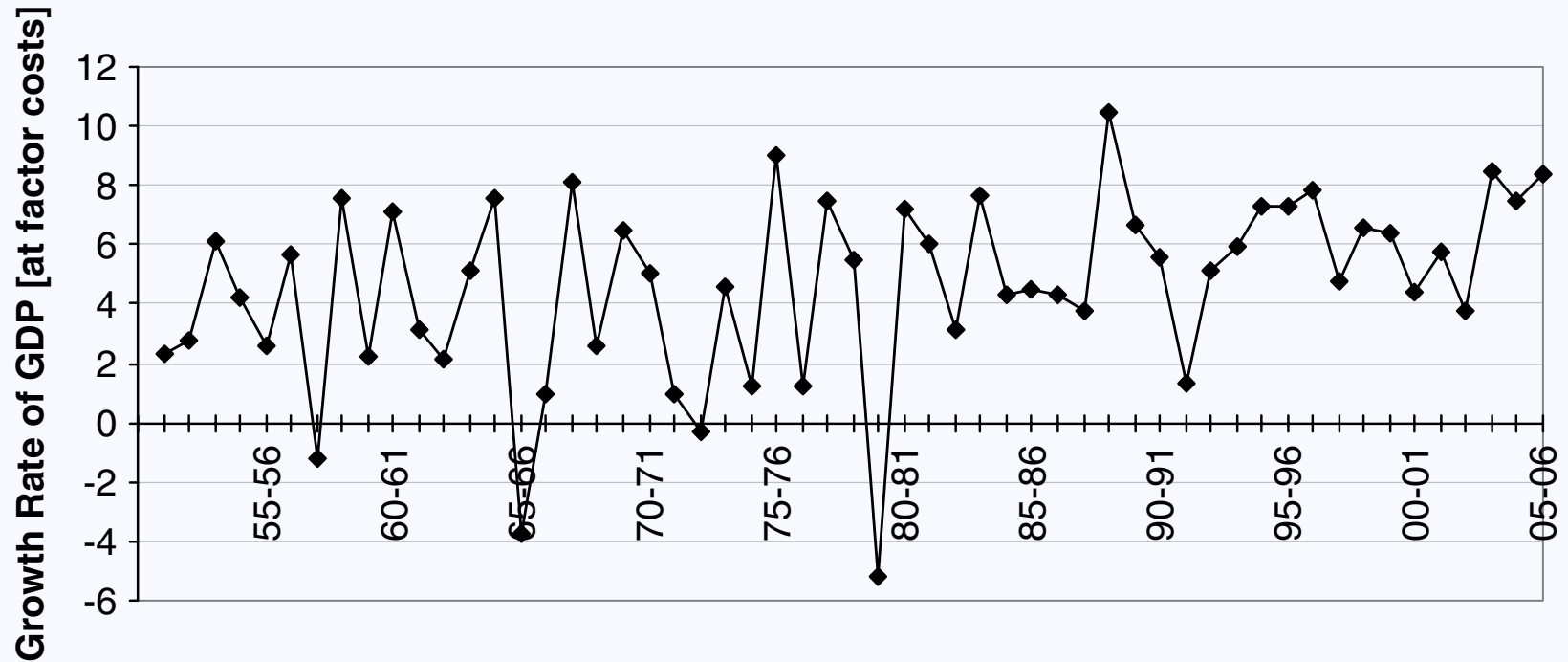
Argentina ...

Australia ...

South Korea ...

INDIA'S GROWTH RATE

Structural Break in Growth Trend



Source: Table 1.

INDIA'S STRUCTURAL TRANSFORMATION

Possible Candidates

- *Bank Nationalisation in late 60s* Burgess & Pande (2005)
- *Large Scale Irrigation Projects in late 60s*
- *Irreverence for government after the Emergency*
- *The X factor ...*

Multiple Equilibria

Endogeneity between economic growth and institutions

Exogenous shock to the institutions shifts equilibria

NEW TRADE THEORY

Increasing returns to Scale

- *Internal to the Firm*

Fixed cost of setting up the factory

- *External to the Firm*

Strategic Complementarities

Agglomeration

NEW TRADE THEORY

Market Size

Evolving Nature of the Shocks

Idiosyncratic shocks

Covariate shocks

DESIGNING THE GOVERNMENT

Leakage of Funds

- *Ugandan school funds newspaper campaign* Reinikka & Svensson (2005)

Media Ownership

- *Government Responsiveness to Floods and Droughts in India*

Besley & Burgess (2002)

Rules and Discretion

- *Obtaining driving licences in India* Mullainathan (2006)

Good and Bad Corruption

- *Tale of Two Cities and a bridge across the river*

ETHNOLINGUSITIC FRACTIONALISATION

Ethnolingusitic Fractionalisation

... can be taken as largely exogenous

Ethnolingusitic Fractionalisation → Market Size

Ethnolingusitic Fractionalisation → Institutions and Policy

FINANCIAL CRISIS AND EUROPE

Europe Policy Making Capabilities & Ethnolinguistic Fractionalisation

Nature of the Shocks

Contagion

External Shock

Reverberations within the system

Europe's Policy Options

Common Monetary Policy

Lack of Fiscal Policy Coordination