Closing Remarks on Part II

Hirofumi Uzawa
UNIVERSITY OF TOKYO

The session reported in Part II of this volume was devoted to the problems of institutions, mechanisms and the evolution of economic systems. The first paper was presented by Professor Hurwicz, entitled 'Mechanisms and Institutions'. The second paper, 'Institutional Change for the Future: Socialist Experience and New Horizons', was presented by Professor Pajestka.

Hurwicz’s paper is concerned with the nature and role of institutions in the processes of resource allocation and income distribution. The main analytical framework adopted by Professor Hurwicz to solve this problem is that of the theory of mechanisms which he and his associates have developed extensively in the last decade or so. The concept of mechanism he employs is broad enough to cover both market and command economies. A mechanism encompasses the pattern of response which each economic agent adopts under given environments, rules and information available to him, and the outcome in terms of the allocation of resources and the distribution of products. It also specifies the rules each agent is obliged to follow and the incentives which govern his behaviour. The outcome of the resource allocation under a given mechanism is compared in terms of various criteria or performance functions which relate the outcomes to economic environments. Hurwicz asks the following question: Given a performance function, is it possible to design a mechanism which realises it? The existence of such a mechanism is provided by direct revelation, but the relevant question is how to design a mechanism which realises the given performance function with minimum message space or other informational requirements.

The problem is then taken up from the game-theoretic framework in which it is possible to extend the criteria from those of Pareto optimality and individual rationality.

Hurwicz then goes on to discuss the conditions under which a given performance function may be implemented by institutional arrangements familiar to us, such as markets. In order to do this, it becomes necessary to extend the normal-form-game-theoretic approach to the model involving games in extensive form. In this respect he argues that the ownership problem is not as crucial as most authors tend to
assume. Following the works of Williamson, he emphasises the extent to which residual control is vested in particular agents as the important feature of institutional arrangements.

Hurwicz’s approach in his paper is similar to that of Schotter’s standards of behaviour, that of the von Neumann-Morgenstern concept of solution in a co-operative game. There is an important difference. While Schotter’s definition of a social institution regards it as a regularity in social behaviour, Hurwicz’s definition regards such behaviour as a feature of a solution determined in part by individual characteristics and in part by the outcome functions which embody institutional arrangements.

Hurwicz emphasises that his concept does not exclude or minimise the importance of the endogenous evolution of institutions. The apparent contradiction between his approach and that of the more traditional one may be resolved if we think of the prevailing outcome function, embodying an enforcement system and various social conventions, as the result of a ‘higher order’ game with a higher order outcome function. Thus, as Ruttan has suggested, it is possible to explain the institutional evolution induced by technological innovation.

Professor Otsuki commented on Hurwicz’s paper from three points of view. His first point was concerned with the cost-benefit analysis of mechanisms, which, however, was pointed out by Professor Hurwicz as being appropriately handled within his framework. Otsuki’s second point was related to that of distributive justice and ownership. He argued that distributive justice might be a criterion much more important than Pareto efficiency, and also that the problem of ownership has to have a direct relevance to implement pre-assigned social goals, both of which have been pointed out by Professor Hurwicz as being within the framework of his approach.

Otsuki’s third point was concerned with the game-theoretic approach for institutional evolution as outlined by Professor Hurwicz. Otsuki extended Hurwicz’s suggestion to sketch an interesting formulation of the process of institutional evolution in terms of an extended form game.

While Hurwicz’s paper was primarily concerned with formal and logical aspects of the theory of institutions, Professor Pajestka’s paper addresses itself to the process of institutional evolution, societal, political and cultural, in a socialist country. He first points out that the problems of institutional evolution, property right economics and constitutional choice, are all familiar and basic