

Chapter 1.1

The Evolution of Institutional Theory and Its Structure

Rustem Nureev

In (his chapter, we shall examine preconditions and the main tendencies in the development of institutional theory. Special attention will be paid to the link between institutional theory and mainstream economic thinking. This link is not simple. Institutional theory and economic thought have passed through various challenges. However, due to this fact, they have both been enriched. Institutionalism constantly criticized mainstream thinking, but it also developed under the effect of neoclassical criticism. Now, each of these theories assumes the other and even creates itself as the other. This has resulted in a transformation of both neoclassical theory and institutionalism, which is a rather complex direction in economic thought, a direction which belongs to the future.

Institutional theory first arose and developed as a doctrine opposing political economy and later economics. This explains why B. Seligman, an American economist, referred to the old institutionalism as a 'revolt against formalism'. 'Revolt' - because institutionalists tried to put forward an alternative concept of the main doctrine; 'against formalism' - because they intended to reflect economic theory not only by means of formal models and strict logic schemes, but also real life.

In order to understand the important role played by institutionalism, as well as the main reasons for and the regularities of its development, we shall provide a brief description of the methodological basis of mainstream classical liberalism.

§1: Revolt against Formalism

Classical Liberalism as an Ideological Background for the Classical School

All representatives of classical political economy and their successors (neoclassics) developed their theories in keeping with a unified concept about the nature of man, society, government, etc. According to the classical liberal paradigm, the individual has his own interests; he is able to defend them in an active independent activity most effectively. Under these conditions, society is considered an aggregate of individuals - 'public interests' as derivatives of the personal – with the best society being one which (to a significant degree) allows the individuals to realize their private interests completely. According to classical liberals, the government is formed by free people to protect their rights as established by a

constitution, and the state should be limited by this function. As there are no objective methods that permit individuals to determine their preferences, the individuals should decide what is correct and what is false, while maximizing the utility function.

Freedom (as key category in the liberal doctrine) is treated as the lack of coercion, as a synonym of autonomy and independence. Public authority arises only as the result of the agreement of individuals, and only individuals can define the reasonable limits of this authority. Equality is understood as the equal chances (instead of the equality of outcomes); thus, attention focuses on the equal protection of rights established by the constitution. The court should protect rights (in keeping with the constitution) and punish those who violate the rights of others. Economic efficiency is attained when the resources are obtained by those who can use them in the best way (paying the most). This gives rise to the Pareto-efficiency - a situation when any individual cannot improve his well-being without thereby worsening the position of others.

The idea of treating the origin of the State and rights as the outcome of the free agreement of free individuals emerged from the theory of social contract (which was popular in modern new times). This concept was initially as special kind of illusion - modernity overturned in the past. It emerged during the religious wars of the 16th and 17th centuries when the feudal regulation consecrated by traditions gradually made way for the conscious regulation of civil society. It was a time of a heightened understanding of justice; honesty and business seemed incompatible. The development of contract ethics, a culture of negotiations, had become necessary. This led to a radical reevaluation of the rights and freedom granted to each individual 'as of birth'.

The theory of social contract considers freedom a 'natural state' for which the rights to life, freedom and property form the basis. These three rights form the constitutional basis of civil society. Each of these rights sets preconditions for another, passes into another, and creates itself as another. The right to life is realized in the activity subordinated to happiness and profit. The right to freedom denies political slavery and tyranny. The right to property is a precondition and warranty for other rights. Freedom of activity is based on independent judgment, individual choice and conscious purpose. Freedom of conscience, speech, press, assembly acts as the major precondition for independent activity, choice of activity, movements.

Certainly, the concept of natural rights and social contract reflected not an actual process of politico-genesis but program requirements of the 'third estate' in its struggle with the absolute state. This concept is an abstraction, an ideal image of market economy where all people are simple producers of commodities who act under conditions of perfect competition. The methodological basis of the classical political economy and later the neoclassical theory of the 19th and 20th centuries were identical.

Thus, the paradigm of classical liberalism (classical and neoclassical) is ahistorical in general. It is intended to represent the laws and institutes of the developed market economy as universal (intrinsic to human nature). It believes that the market is eternal and universal; it makes understanding market (pre-market and post-market) social relations impossible. Classical liberalism is efficient mainly for studying the modern history of economic history of recent centuries. In other cases, its creative possibilities are limited.



© 2004 Roman Zheleznyak. All rights reserved

Having emerged on American soil, institutionalism has incorporated many ideas of the German historical school, the English Fabians, and the French sociological tradition. It is impossible to deny the influence of Marxism on institutionalism. The old institutionalism arose at the end of the 19 century and took shape as a certain direction in the 1920s-1930s. It attempted to take a middle ground between economics and Marxism. The old institutional economics tried to analyze institutions and reject classical economic theories.

In 1898, T. Veblen (1857-1929) criticized G. Schmoller for excessive empiricism. Schmoller tried to describe economic reality and incorporated the rules of human interaction. In an attempt to answer the problem 'Why is economics not an evolutionary science', Veblen put forward an interdisciplinary approach instead of narrow economic approach that would involve social philosophy, anthropology and psychology. It was an attempt to turn economic theory into social problems.

In 1918, the notion of 'institutionalism' appeared. W. Hamilton defines institution as 'a widespread way of thinking or acting embodied in habits of groups and customs of the people'. From his point of view, institutions fix customary procedures and reflect general consent and arrangement. Institutions include: customs, corporations, trade unions, the state and so on. The so-called 'old institutionalism' of the American tradition includes the well-known works of T. Veblen, J. R. Commons, J. M. Clark and W. C. Mitchell. Many ideas were developed by C. E. Ayres, G. Myrdal, K. Wittfogel and J. K. Galbraith.

In 1899, Veblen's book *The Theory of the Leisure Class* was published. According to Veblen, a leisure class came together with the institution of ownership. Veblen looks at consumption as a class and evolutionary phenomenon. For Veblen, if people in society produce more goods than are required, this gives rise to the emergence of the leisure class. The production of a surplus leads to the institution of private property. It becomes indispensable to accumulate, to acquire property, in order to retain one's good name'. Veblen points out two ways in which individuals can display wealth to others: expenditure on leisure activity and expenditure on consumer goods. Veblen calls the first type of behavior 'conspicuous consumption'. Veblen identifies two main features of ownership: competition among individuals and waste depending on taste. For Veblen, emulation entails an endless quest for ownership.

In 1904, Veblen's book *The Theory of Business Enterprise* was published. Veblen analyzes dichotomies between industry and business, rationality and irrationality. He contrasts behavior caused by real knowledge with behavior caused by habits of thinking, considering the former a source of change for progress, and the latter the factor which counteracts it. In his work *The Instinct of Workmanship* (1914), Veblen formulates a new concept of 'idle curiosity'. Following this, he wrote *The Place of Science in Modern Civilization and other Essays* (1919), *The Vested Interests and the Common Man* (1919), and *The Engineers and the Price System* (1921). He analyzes the important problems of scientific and technical progress and the role of engineers as managers in a rational industrial system. He associates the future of capitalism with them.

W. Mitchell (1874-1948) obtained a B A and PhD from the University of Chicago. He was a professor at the University of California (1903-13) and Columbia University (1913-19). He was the Director of the New School of Social Research (1919-31) and the Director of the National Bureau of Economic Research (1920-45). He focused his thinking on the problems of business cycles and business research. W. Mitchell was a pioneer institutionalist analyzing actual processes 'with figures in hands'. In his work *Business Cycles: The Problem and Its Setting* (1927), he investigates a gap between the dynamics of production and price movement.

In his next book, *The Backward Art of Spending Money* (1937), he criticizes neoclassical economics, which was based on the behavior of the rational individual. He sharply criticized J. Bentham and demonstrated the various forms of human irrationality. He tries to use statistics to explain the difference between actual behavior in the economy and hedonistic egoism. For Mitchell, the real economic subject corresponds to central tendency. Analyzing a nonrationality of spending in family budgets, he stresses that the art of 'making considerable amounts of money' is more advanced than capacity to spend it rationally.

J. R. Commons (1862-1945) made an outstanding contribution to the development of old institutionalism. He focused his attention in *Distribution of Wealth* (1893) on a search for means of compromise between trade-unions and big business. They include the eight-hour working day and a wage-push that leads to

increasing the purchasing capacity of the population. He argues in favor of industrial concertation as a means to increase efficiency.

In *Industrial Goodwill* (1919) and *Legal Foundations of Capitalism* (1924), he sequentially discusses the idea of social agreement between workers and business people by means of mutual concessions. He shows that the diffusion of capitalist property further promotes a more equal distribution of wealth.

In 1934, in his book *Institutional Economics*, he uses the concept of transaction. Commons singles out three basic elements in the structure of the transaction: negotiating, assuming obligations and fulfilling. He also characterizes various kinds of transactions: bargaining, managerial and rationing. According to Commons, the transactional process is a process of determination of 'reasonable value' which is completed by the contract governing the warranties of expectations (Commons, 1934). In the final years of his life, he focused his attention on the legal frameworks of collective action and, above all, courts. This was reflected in his final work *Economics of Collective Action* (1951).

Attention to civilization as a complex social system has played a methodological role in post-war institutional concepts. In particular, it has found peculiar reflection in the works of K. Wittfogel (1896-1988), an American institutionalist, professor at the Columbia University and University of Washington and, above all, in his book *Oriental Despotism: A Comparative Study of Total Power* (1957). The structural element of Wittfogel's concept is despotism, which is characterized by the leading role of the State. The State relied on the bureaucracy and suppresses the development of tendencies towards private property. The wealth of the prevailing class in this society is explained not by ownership of the means of production, but by place in the hierarchical system of the State. Wittfogel was of the opinion that natural environments and external influences determine the form of the State, and it in turn determines the type of social stratification.

The works of K. Polanyi (1886-1964) and, above all, *The Great Transformation* (1944) played a significant role in the development of the methodology of modern institutionalism. In *Economy as the Instituted Process* he emphasized three levels of exchange: reciprocity or mutual exchange on the natural basis, redistribution and commodity exchange which underlies market economy (Polanyi, 1957b, see Chapter II. 1, §1.3).

Although each of these institutional theories is subject to criticism, nevertheless a list of the reasons for dissatisfaction with modernization shows how the views of the scientists changed. The focus of attention shifted from weak buying capacity and ineffective consumer demand, from low level of savings and investments, to the significance of a system of values, problems of alienation, tradition and culture. Even if resources and technology are considered, they are examined in connection with a social role of knowledge and environmental problems.

The research of J. K. Galbraith (b. 1908), an American institutionalist is focused on the problems of technostructure. In his work, *American capitalism: The Concept of Countervailing Power* (1952) he writes about managers as carriers of

progress. He considered trade unions to play a countervailing role along with big business and government. The idea of scientific and technical progress and post-industrial society can be seen in his works *The New Industrial State* (1967) and *Economics and the Public Purpose* (1973). According to Galbraith, there are two systems in modern society: planned and market. In the former, technostructure plays the leading role which is based on monopolizing knowledge. Only the holders of knowledge make decisions apart from the holders of capital (Galbraith, 1969, pp. 100-113). Such a technostructure exists under both capitalism, and socialism. Their growth pulls the development of these systems together, predetermining a tendency to convergence (Ibid., pp. 100-113).

§2: The Development of Classical Tradition: Neoclassical Theory and Neoinstitutionalism

1. The Concept of Rationality and Its Development in the Course of Making Neo institutionalism

Neoinstitutionalism has arisen out of the process of overcoming the limited understanding of rationality (one of the features of neoclassical economics). Therefore, we shall describe preconditions, the main features of understanding of rationality in neoclassical theory, and also the schools which exist within it.

As for neoclassical theory, rationality is the maximization of utility within the limits of given resources, the maximization of individual knowledge, and the maximization of expectations concerning a partner's action. It is supposed that rational individuals are capable not only of comparing benefits and costs, but also understanding the consequences of activity. At the same time, conventional norms, traditions and customs play a rather modest role in the neoclassical constructions. The need for decreasing uncertainty forces the economic agents to rely on traditions. Where uncertainty predominates, neoclassical assumptions lose their universal validity. Maximization can be senseless and the rational individual has to take acceptable social outcomes into account. Moreover, what was rational yesterday can appear irrational today.

The axiom of rationality does not focus on a comprehensive description of reality. It represents an ideal type of this reality, which serves to formulate the basic hypotheses of behavior of the individuals regardless of the sphere of business. The theory of rational choice is universal. It formalizes the logic of the individual's behaviour in various situations. In the sphere of politics, it is called the theory of

public choice; in sociology, the theory of social choice; in history, cliometrics; in the sphere of law, economics and law.

Although the concept of rationality is rather disputable, the general definition of rationality can be viewed as follows: 'The subject (1) never will choose alternative X, if at the same time (2) he has alternative Y which, from his point of view, (3) is more preferable than X' (Shvery, 1997, pp. 37-46). The marked figures reflect three major characteristics of rationality: individual decision-making, boundedness and subjectivity.

In the theory of rational choice, the purposes of the individuals are considered as predetermined and dependent on the individuals. Therefore, in a limiting case, there are so many different kinds of rationality as the total number of people (taking into account the change in their preferences over time).

The theory of rational choice overcomes the boundedness of neoclassical theory as it takes into account the fact that time, transaction costs, and information play the important role in day-to-day decisions. Therefore, the theory of rational choice formulates rationality not only in the strictest form (for example, the principle of maximization), but also in a less strict form (with the limitation in time): when the people do not achieve a maximum but want to get a certain level of satisfaction. Therefore, this involves the development made by R. Coase (transactional costs), H. Simon (bounded rationality), G. Stigler (incompleteness of information), and G. Becker (uncertainty in family relations).

The theory of rational choice involves the concept of methodological individualism as incorporated in the works of T. Hobbes, B. Mandeville, A. Ferguson, K. Menger. It means that the structures are considered as the combination of individuals pursuing their purposes. This type of approach does not involve absolutizing egoism. The person, making his choice, can act altruistically. The interests of the individual are usually limited to certain moral obligations (A. Sen).

The basis for our analysis will be the research program of the neoinstitutionalists in the 1970s-1990s.' The research program of neoinstitutionalism modifies the classical microeconomic program rejecting most doubtful assumptions. However, at the same time, it adopts its basic assumptions as the core of the research program. First of all, the main assumption is the stability of individual preferences which results in equilibrium analysis. The other assumption is the rationality of the agents' behavior. Institutional economics uses property rights as the tool of analysis, rejects assumptions concerning ideal market, and emphasizes the existence of transactional costs. The other assumptions (imperfect information and unbounded rationality of the agents operating on the markets), are also modified.²

The neoinstitutional approach focuses on the fact that the outcome will depend on the behavioral model of the individual and that institutions matter. The rejection of the ideal models of the neoclassical approach results in new decisions and outcomes, with imperfect information, bounded rationality, and the opportunistic behavior of the participants (see also Chapter 1.3, §4)

Imperfect information The assumption about perfect information seems unrealistic and noticeably narrows the application of the area of economic research. In many respects, the development of economic science in the 20th century was determined by the study of the problems of uncertainty and the problems connected with them as the search for information and its consequent processing (works of F. Knight, 1921, concerning the problems of uncertainty and risk, the theory of utility of von Neumann and Morgenstern, 1970, and the economics of information of G. Stigler, 1995). Bounded rationality Simon's theory of bounded rationality developed alternate procedures of choice under incomplete information. The decision-making process has two stages: (1) the search and (2) the acceptance of the satisfactory version. But Simon's concept, like the Stigler's theory of information, in which were no alternatives available, argues that we cannot maximize any utility function (Simon, 1979, p. 285). Opportunism The concept of opportunistic behavior is directly connected to the motivation of the economic agent. If originally the motive of self-interest was treated as 'selfish', this emotional colouring now has no meaning. The theory gave rise to the concept of opportunism which is treated as 'self-interest seeking with guile' (Williamson, 1985, p. 47). Hence, opportunism is the strongest form of the focus on self-interest. Opportunism is the source of behavioral uncertainty in economic transactions (Ibid., p. 49).

Table I.1.1 Schools of the rational choice theory

Schools	Rational Choice Theory		
	Public Choice Theory		Social Choice Theory
	Chicago	Virginia	
The main postulates	Self-regulated market and optimal choice within given constraints	Optimal choice of constraints (rules of game)	Constructing a function of social welfare to aggregate individual preferences
Focal point	Market success	Political failure	Political success and/or market failure
Key people	M. Friedman, R. Coase, G. Stigler, G. Becker, S. Peltzman, R. Posner	J. Buchanan, J. Brennan, W. Bush, R. Wagner, G. Tullock, D. Muller, R. Tollison	A. Bergson, K. Arrow, A. Sen, J. Roehmer, J. Elster, K. Moene

Within the framework of the theory of rational choice, there are two approaches: public and social choice, the former has two schools: Chicago and Virginia (see Table 1.1.1). Although the difference between them gradually decreases, we shall examine their main features.

The Chicago School (formed in the mid-1930s) emphasizes market success and believes the neoclassical theory of pricing mechanism and market efficiency. The Virginia School developed at George Mason University in the 1950s. The Virginia School focuses on political failures. Moreover, the politics is treated as an exchange. And, in this exchange, the representatives of the Virginia School are interested in the normative analysis of ethical fundamentals of constitutional economics.

Unlike the Virginia School, the theory of social choice (guided by K. Arrow) tries to construct a function of social welfare reflecting the interests of different groups of the individuals in the best way. It characterizes institutions not as a mechanism of rules and procedures helping to make a choice, but as the tools for reaching an equilibrium underlying the political game.³

Constitutional choice According to J. Buchanan, constitutional choice is the choice among constraints in contrast to choice under constraints. Buchanan defines a constitution as 'a set of rules which constrain the activities of persons and agents in the pursuits of their own ends and objectives' (1977, p. 292). In his article 'Individual Choice in Voting and the Market' (1954), he marked two levels of public choice: 1) the original constitutional choice (which is made before the acceptance of the constitution) and 2) post-constitutional choice. At the first stage, the rights of individuals are established and the rules of relationships between them are developed. At the post-constitutional stage, the strategy of individuals' behavior of individuals is formed within the framework of established rules.

J. Buchanan draws an analogy with a game: at first, the rules of the game are determined and then, within the framework of these rules, the game is implemented. According to J. Buchanan, a constitution is a set of rules for managing a political game. The current policy is the outcome of game according to constitutional rules. Therefore, productivity and policy efficiency depend on the initial constitution. According to J. Buchanan, the constitution is (first of all) the main (higher) law not of the State, but of civil society.

However, there is the problem of 'bad infinity': in order to adopt the constitution, it is necessary to produce pre-constitutional rules on which it relies. To overcome this methodological dilemma, Buchanan and Tullock offer a rule of unanimity for the adoption of the initial constitution in a democratic society. Certainly, it does not solve this problem, as the inclusive problem is substituted by a procedural one. However, the history of the US provides such an example. In 1787, there was a classical (in many respects unique) example of a deliberate choice of rules in the political game. Under the conditions of the absence of universal suffrage, the Constitution of the US was adopted at the constitutional meeting.

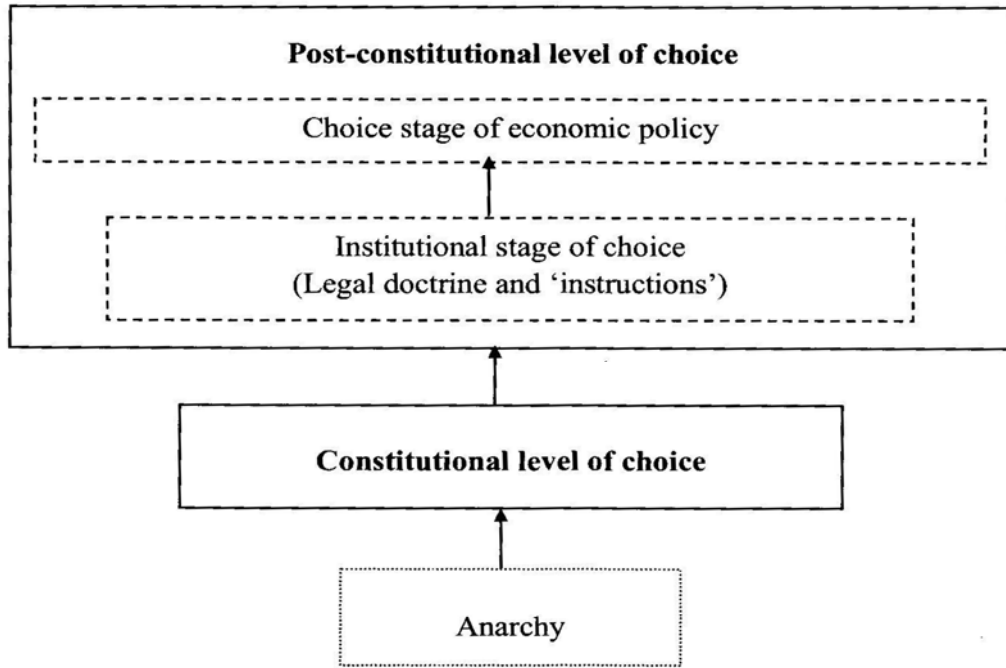


Figure I.1.1 Stages of public choice

Post-constitutional choice Post-constitutional choice means a choice, first of all, of the rules of game, that is legal doctrines and working rules which help to determine the particular directions of economic policy regarding the production and distribution of public goods (see Figure 1.1.1).

Solving the problem of market failure, the State intends to determine two interconnected problems: to promote the normal functioning of market and to decide pressing socio-economic problems. In this respect, we can highlight antitrust legislation, social security, the limitation of production with negative externalities and the expansion of production with positive externalities, and the production of public goods.

2. Comparative Characteristics of the 'Old' and 'New' Institutionalism

Although institutionalism as the special current was developed in the early 20th century, for a long time it was on the periphery of economic thought. The explanation of the movement of economic goods by means of institutional factors did not find a large number of supporters. In part, it was connected to the ambiguity of the concept of 'institution', which some authors understood mainly as customs, while others viewed it as trade unions, still more as a State, and yet others as corporations and so on. Institutionalists also tried to use the methods of other social sciences in economics: law, sociology, politology, etc. As a result, they lost the ability to speak in a unified language of an economic science using schedules and formulas. Certainly, there were other objective reasons.

However, the situation changed radically in the 1960s-1970s. To understand this change, all that is required is a comparison of the 'old' and 'new' institutionalism. Between the 'old' institutionalists (T. Veblen, J. Commons, J. Galbraith) and neoinstitutionalists (R. Coase, D. North, J. Buchanan) there are at least three radical distinctions.

Table I.1.2 Radical distinctions between the ‘old’ institutionalism and neoinstitutionalism

Indications	Old institutionalism	Neoinstitutionalism
Movement	From the law and politics to economics	From economics to politics and law
Methodology	Other social sciences (law, politology, sociology, etc.)	Neoclassical economics (methods of microeconomics and game theory)
Method	Inductive	Deductive
Focal point of attention	Collective action	Independent individual
Assumptions	Holism	Methodological individualism

First, the 'old' institutionalists (for example, J. Commons in his *Legal Foundations of Capitalism*) approach economics from the point of view of law and politics, in an effort to try to study the problems of modern economic theory by methods used by other sciences. Neoinstitutionalists use a completely different way: they study political and legal problems using the methods of neoclassical economics and using modern microeconomics and game theory.

Second, traditional institutionalism essentially relied on the inductive methods and intended to move from particular cases to generalizations. Therefore, no common institutional theory has been developed. Neoinstitutionalism uses a deductive method: from the general principles of neoclassical economics to the explanation of the particular phenomena of social life.

Third, the 'old' institutionalism as the current of a radical economic thought focused on the actions of groups (mainly, trade unions and government groups) dealing with the protection of the interests of the individual. Neoinstitutionalism focuses on the independent individual who chooses which organisation is more expedient to him. In recent decades, we have observed the growth of interest in institutional research. Partly, it is connected with the attempt to overcome the boundedness of a set of assumptions in economics (axiom of unbounded rationality, perfect information, perfect competition, equilibrium only by means of pricing mechanism). This gave rise to the need to examine modern economic, social, and political processes more completely and comprehensively. And this, in turn, gave rise to analyze the phenomena of technological progress because traditional tools cannot provide clear results.

3. Neoclassical Economics and Neoinstitutionalism: Unity and Distinctions

The common position for all neoinstitutionalists is as follows: at first, social institutions play a significant role; second their analysis requires standard tools of microeconomics. In the 1960s-1970s, a phenomenon emerged, which G. Becker called 'economic imperialism'. In this period, such economic concepts as maximization, equilibrium, and efficiency were employed in the field of education, family relations, public health, criminality, politics, etc. As a result, the basic economic notions of neoclassical theory received a stricter interpretation and were given a broader application.

Each theory consists of a 'hard core' and a 'protective belt'. This also concerns neoinstitutionalism. Neoinstitutionalism and neoclassical economics have the same main assumptions:

- 1 Methodological individualism;
- 2 The concept of the economic man;
- 3 Activity as exchange.

However, neoinstitutionalism uses these principles more sequentially.

Methodological individualism With limited resources, each of us makes a choice from the alternatives available. The methods for analyzing the market behaviour of the individual are universal. They can be applied to any area where the individual should make a choice. The main assumption of neoinstitutional economics is that people pursue their personal interests when acting in any area, and there is no insuperable edge between the business and social sphere or politics.

The concept of economic man The second assumption of neoinstitutional theory is the concept the 'economic man' (*homo oeconomicus*). The individual in a market economy identifies his preference in terms of goods. He or she intends to make decisions that maximize the utility function. Hence, his/her behavior is rational.

The rationality of the individual has a universal value. This means that all people use economic principles in their activities, namely, they compare marginal

benefits and marginal costs (and, first of all, profits and costs connected to a decision making

$MB > MC$, where MB - marginal benefit; MC - marginal costs

However, unlike neoclassical economics, which considers mainly physical (scarcity of resources) and technological limitations (lack of knowledge, practical skill, etc.), neoinstitutional economics also examine transaction costs, i.e. costs connected to the exchange of property rights because any activity is considered as exchange.

Activity as exchange The supporters of neoinstitutional economics see any area as a market of goods. Under such an approach, the State is an arena of competition between people for influence over decision-making, access to resource allocation, hierarchical order. However, the State is a market of the special kind. The participants have unusual property rights: voters can select representatives, deputies may adopt laws, officials may monitor their fulfillment. The voters and politicians are treated as individuals that can exchange voices and pre-election promises.

It is important to note that neoinstitutionalists more realistically evaluate the features of this exchange taking into account bounded rationality and decision-making process linked with risk and uncertainty. Furthermore, in a real economic life we do not always achieve the best solution. Therefore, institutionalists compare the costs of decision-making not to an ideal situation in microeconomics (perfect competition), but to actual alternatives which exist in practice.

This type of approach can be supplemented by the analysis of a collective action,⁴ which assumes consideration of phenomena and processes from the point of view of interaction not of one individual but whole group. People can be united in the groups according to social, property, religious or partisan signs.⁵

Thus, institutionalists can deviate from the principle of methodological individualism, assuming that the group can be considered as the final indivisible object of the analysis, with utility function, limitations, and so on. Hence, the more rational approach is the approach to the group as to an association of some

individuals with their utility functions and interests.⁶

Some institutionalists (R. Coase, O. Williamson, etc.) characterize the distinctions listed above as the true revolution in economics. Other economists (for example, R. Posner) consider their work as the continuation of the development of the mainstream economic thought. All these theories are integral part of

contemporary textbooks on economics. Let us (for more details) examine the structure of modern institutional theory.

§3: The Main Directions of Institutional Theory

1. The Structure of Institutional Theory

The unified classification of institutional theories has not been developed yet. First, there is the dualism between the 'old' institutionalism and neoinstitutionalism.

Both schools of modern institutionalism were formed on the basis of neoclassical theory or under its influence (Figure 1.1.2).

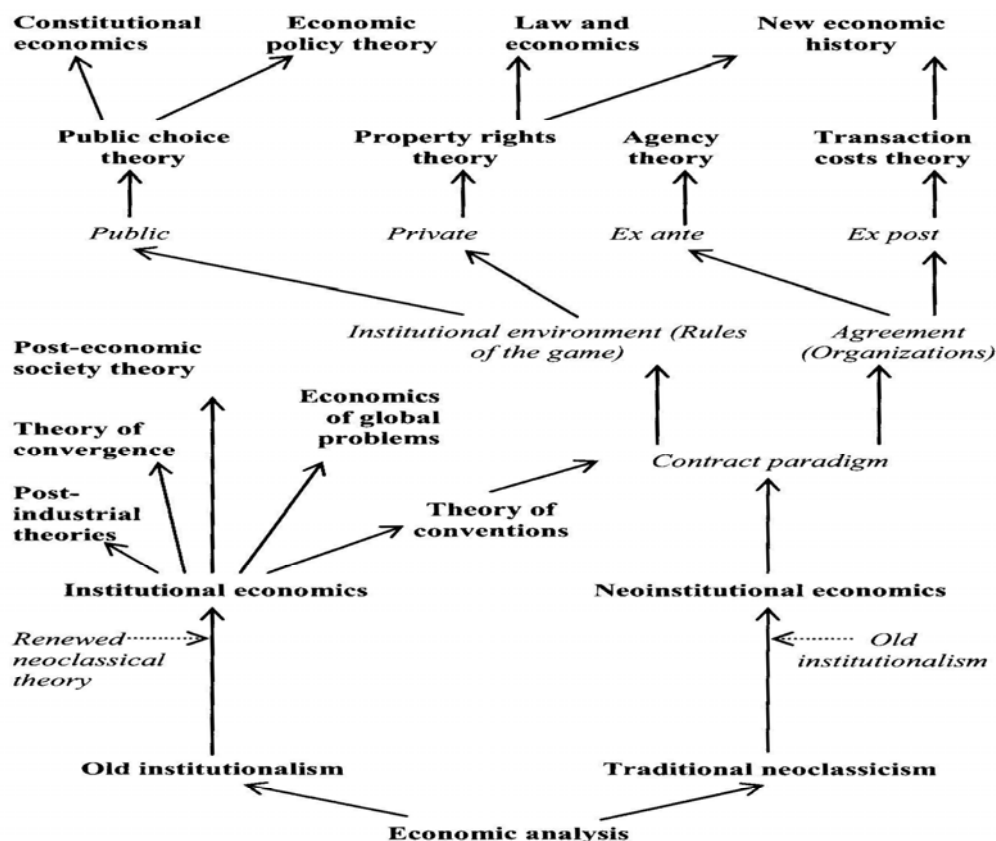


Figure I.1.2 Classification of institutional concepts

Thus, neoinstitutionalism developed by expanding and supplementing the main ideas of economics. Interfering in the sphere of other sciences (law, sociology, psychology, political science, and so on), this school used traditional microeconomic methods of analysis to try to investigate all social relations from the point of view of rational thinking (*homo aeconomicus*). Therefore, any relations between the people here are viewed through a prism of mutually advantageous exchanges. This type of approach (since the time of Commons) is called a contractual paradigm (Buchanan, 1962).

If, within the framework of the first direction (neoinstitutional economics), the institutional approach has only expanded and modified traditional neoclassical approach while remaining within its limits and removing only some of the most unrealistic assumptions (axiom of full rationality, complete information, perfect competition, equilibrium only by means of price mechanism, etc.), the second approach (institutional economics) has to a certain degree relied on the 'old' institutionalism (often 'left-wing').⁷

If the first approach strengthens and expands the neoclassical paradigm, subordinating all new and new spheres of research (family relations, ethics, political life, interracial relations, criminality, historical development of society, etc.), the second leads to a denial of neoclassicism opposing institutional economics to the neoclassical mainstream. Modern institutional economics rejects the marginal methods and equilibrium analysis using evolutionary-sociological methods (the convergence concept, the concept of post-industrial and post-economic society, economics of global problems). Therefore, the representatives of these schools chose the sphere of the analysis which is beyond the limits of the market economy (the problem of creative activity, overcoming private property, liquidation of exploitation and alienation, etc.).⁸ Rather separately within the framework of the given direction, there is only French theory of conventions trying to bring the new basis under the neoinstitutional economics and first of all under its contract paradigm. This basis, from their point of view, consists of the conventions.

The contract paradigm from the first approach arose out of Commons' research. However, it has another interpretation now. A contract paradigm can be realized from the outside, i.e. through the institutional environment (the choice of social, legal and political rules of the game), and through the relations which underlie organizations.⁹ For the first case, the rules are constitutional law, property rights, administrative law and various legal acts. For the second case, the rules of game are the rules of the internal schedules of organizations. In this respect, the property rights theory (R. Coase, A. Alchian, H. Demsetz, R. Posner, etc.) studies the institutional environment of the activities of economic organizations in the private sector of the economy, and the public choice theory (J. Buchanan, G. Tullock, M. Olson, R. Tollison, etc.) investigates the institutional environment of the activities of individuals and organizations in the public sector. While the first approach emphasizes the welfare surplus due to the precise specification of property rights,

the second direction analyzes the losses of the State (economics of bureaucracy, rent-seeking, and so on).

It is important to note that property rights are (first of all) the system of the norms regulating access to limited resources. Under this type of approach, property rights have an important behavioral value, since it is possible to compare them with the rules of the game that regulate the relationship between economic agents.

The theory of agency ('principal-agent' relationships, J. Stiglitz) concentrates on the preliminary premises (incentives) of contracts (*ex ante*), and transactional cost theory (O. Williamson) focuses on realized agreements (*ex post*) generating a varied administrative structure. The theory of agency considers various mechanisms that encourage the action of subordinates, and organizational schema ensuring optimum distribution of risk between the principal and agent. These problems arise in connection with the separation of capital-property from capital-function, i.e. the separation of property from control (these problems were examined in the works of A. Berle and G. Means in the 1930s). Modern contributors (W. Meckling, M. Jensen, E. Fama, etc.) study the measures which are necessary to minimise the deviation of the agents' behaviour from the interests of the principals (see Chapter 1.4). Whereas they try to provide these problems beforehand (*ex ante*), the transactional cost theory (S. Cheung, Y. Barzel, etc.) concentrates on the behaviour of economic agents after the contract was made (*ex post*). Special impetus was given to this theory by the works of O. Williamson. He focuses on the problem of governance structure and regulation.

Certainly, the distinctions between the theories are rather relative and frequently it is possible to observe how any scientist works in the different fields of institutionalism. Especially, it concerns such particular directions as 'law and economics', industrial organization, new economic history, and so on.

There are many differences between American and Western European institutionalism. The American tradition of economics is at the higher level, although European institutional researchers are strong competitors. It is possible to explain these distinctions by different national-cultural traditions. The American approach relies on the positions of the rational individual. Western Europe is the cradle of modern culture; it rejects this opposition of the individual and society, identifying interpersonal relationships only with market bargains.¹⁰ European institutionalism underlines the major role of traditions, cultural norms, affects (the main features of the new institutionalism). If the representatives of American neoinstitutionalism consider the norms a result of choice, French neoinstitutionalists believe that norms are the preconditions for rational behavior. Rationality, therefore, also is the norm of individual behavior.

2. *New Institutionalism*

In modern theory, institutions are understood as 'the humanly devised constraints that... structure incentives in human exchange, whether political, social, or economic' (North, 1997a). Institutions can be divided into formal (constitutions, laws, contract enforcement, rules, property rights) and informal (traditions, customs, taboos, conventions).

Thus, formal institutions are understood as the rules made and supported by entitled people (officials). Informal institutions are usually understood as conventional conditionalities and ethical codes of conduct. They are the result of the joint existence and cooperation of people. As a result, people understand one another easily. These codes of behavior are formed by culture. That is why history is 'largely a story of institutional evolution' (North, 1991).

Institutional structures support market transactions, help transmit information between individuals and give individuals incentives. The property rights embedded in different institutions affect choices systematically and predictably. Exchange provides individuals with the opportunity to specialize in their activities. Property rights are *realized* through a system of incentives (anti- incentives) and a set of alternatives with respect to economic agents. The choice of a certain direction of activities is finished by contracting (see Figure 1.1.3).



Figure I.1.3. Realization of property rights in contracts

Private property means that individuals can transact with others on any mutually agreeable terms in keeping with institutional rules.

3. *The Strength and Weakness of Russian Institutionalism*

In Russia, we have recently witnessed a growing interest in institutional economics (in general) and in neoinstitutional economics (in particular). The works of J. Galbraith, G. Myrdal, and T. Veblen were translated into Russian even during the Soviet time. On the other hand, there appears to be an attempt to surmount the limited nature of a number of the assumptions in economics (the axiom of

rationality, complete information, perfect competition, equilibrium by means of price mechanism, and so on), and a need to consider contemporary economic processes comprehensively.

The publication of courses on microeconomics, including special chapters on neoinstitutional economics (P. Heyne, E. Dolan, D. Lindsey, D. Hyman, and the Russian textbook of R. Nureev), played an important role in the popularization of institutionalism.

The perception of the importance of creating a 'soft infrastructure' for the Russian market economy gave a thrust to the development of domestic neoinstitutionalism. A multitude of special works (concrete and empirical as well as abstract and theoretical), in which neoinstitutional ideas are used to explain specific features of contemporary Russian economy, were published. Leading Russian journals such as *Voprosy ekonomiki* and *Ekonomika i matematicheskie metody* regularly publish articles concerning institutional problems. However, for a long time there were no attempts to classify the institutional approach. Thus, the publication of A. Shastitko's book in 1998 *Neoinstitutsional'naiia ekonomicheskaiia teoriia* [Neoinstitutional Economic Theory] along with *Uchebno-metodicheskoe posobie k kursu lektsii po institutsional noi ekonomike* [Teaching Methodological Reference for a Lecture Course on Institutional Economics] written by Y. Kuz'minov in 1999, as well as the publication of A. Oleinik's textbook *Institutsional'naiia ekonomika* [Institutional Economics] in *Voprosy ekonomiki* (1999) were timely and helped to examine the various ways in which economists are seeking to investigate and explain institutional changes.

The circle of Russian studies regarding the problems of neoinstitutional theory is quite broad. Russian scholars use institutional concepts analyzing the post-Soviet economy: S. Avdasheva, V. Antonomov, O. Ananyin, A. Auzan, S. Afontsev, R. Kapeliushnikov, Y. Kuz'minov, Y. Latov, V. Maevskii, S. Malakhov, V. Май, V. Naishul', A. Nesterenko, R. Nureev, A. Oleinik, V. Polterovich, V. Radaev, V. Tambovtsev, L. Timofeev, A. Shastitko, M. Yudkevich, and A. Yakovlev." But the absence of organizational unity and specialized periodicals, which relies upon the fundamentals of the institutional approach, is a serious barrier to the promotion of the theoretical and empirical analysis of Russian economy.

Notes

¹ For more detailed characteristics of neoinstitutional program see: (Eggertsson, 1990; Kasper, Streit, 1999; Furubotn, Richter, 2000).

² We support the concept of 'functional rationality' proposed by V. Avtonomov (1998, pp. 12-19).

³ See, for example: (Schotter, 1981; Kreps, 1990).

⁴ See for more details: (Stevens, 1993).

⁵ The characteristics of these approaches can be found in: (Reisman, 1990).

⁶ See: Olson M. *The Logic of Collective Action: Public Goods and the Theory of Groups*, Cambridge, MA: Harvard University Press, 1965; *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, New Haven, CT: Yale University Press, 1982; *Power and Prosperity: Outgrowing Communist and the Capitalist Dictatorships*, New York: Basic Books, 2000.

⁷ The term 'new institutional economics' is found in Williamson's work (1975, pp. 35- 44). But we believe that he is a representative of neoinstitutional economics.

⁸ See, for example: (Inozemsev, 1998).

⁹ We refer to Williamson's taxonomy of neoinstitutional theories (1990, pp. 61-71).

¹⁰ For a discussion of this concept see the works of A. Oleynik, L. Thevenot, O. Favereau, R. Kumahov, F. Eymard-Duvernay published in a special issue of the review *Voprosy ekonomiki* (1997, No. 10, pp. 58-116).

¹¹ For more details see: Nureev R., Latov Y., 2001, 'Fruits of Enlightenment', *Voprosy Ekonomiki*, No. 1.

Institutionalism in a New Economic History

Rustem Nureev
(with Yuri Latov)

§1: A New Economic History, Cliometrics, and Institutional Economic History

1. Institutionalism in Theories of Economic History

The development of institutional economic history reflects the general trends of the development of institutionalism. The writings of scientists working at the beginning of the 20th century during the epoch of 'old institutionalism' were very popular (M. Weber, V. Zombart, K. Polanyi, N. Elias). All these scientists used sociological methods for studying economic history (essentially the history of the genesis of capitalism). In the second half of the 20th century, the sociological approach to economic history continued to be developed in the work of K. Wittfogel, as well as by representatives of economic anthropology (M. Sahlins) and researchers involved in world-systems analysis (I. Wallerstein, F. Brodel). But in the 1950s, the sociological 'challenge' generated the 'answer' of professional economists. In other words, this is a scientific trend that arose in the US and came to be known as a new economic history and cliometrics. The highest expression of authority in this respect is the Nobel Prize in Economics that was awarded (in 1993) to D. North and R. Fogel (the most outstanding representatives of the field).

Only in logical terms is it easy to understand that highly varied versions of economic history can develop (although in many respects they are distinct (Figure 1.6.1) at the intersection of these three sciences.

At first, connecting history with statistics without involving economics (area 1) is possible. These are the areas of quantitative history that study the development of political processes, the influence of climate on history in the context of the analysis of historical documents, and consider the long-term trends of historical growth etc. We can consider the Russian scientists of the 1920s the Founding Fathers of this version of cliometrics (A. Chijevsky who developed a quantitative correlation between cycles of solar activity and the intensity of historical events in *Physical factors of historical process*, 1924;¹ N. Kondratiev who proved the existence of 'long-wave cycles' in his book *Long Cycles of Economic Conjuncture*, (1926)² by processing of the large bases of historical information). Although their ideas were eliminated from broad scientific discussion in Russia towards the end of 1980s, they acquired many followers in the field of foreign economic history. Numerous works on the history of national accounts - works by A. Vainstein (1960), P. Gregory (1982), V. Meljantsev (1996) and others also apply. R. Fogel, who was interested in economic anthropology (1994, 2003), was involved in

studying cliometrics without economics. This version of quantitative history has been developed in-depth in the USSR and post- Soviet Russia (I. Kovalchenko's school of thought emerged in the 1960s, a little later than American cliometrics³). All these schools of thought have little or no impact on institutionalism.

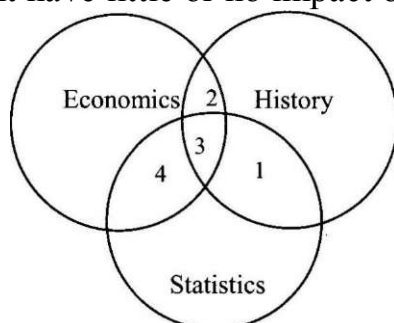


Figure 1.6.1 The interaction of economics, history and statistics

where 1 - quantitative history without economics, 2 - theoretical economic history without economic-mathematical modeling; 3 - theoretical economic history with economic- mathematical modeling; 4 - econometrics (area of cliometrics - 1 and 3, a new economic history-1, 2 and 3).

Although the expressions a 'new economic history' and 'cliometrics' are frequently used as synonyms and linked to institutional economic history, they are not identical at all.

Second, it is possible to connect history with economic theory without using the methods of economic-mathematical analysis (area 2). Thus, economic history necessarily relies on a paradigm of economics although not necessarily on an institutional paradigm. The work of S. Kuznets and W. Rostow is not considered a new economic history. Yet their work (1950s-1960s) contained economic theories (and even elements of economic-mathematical modeling) for analyzing the aspects of economic history that are connected to economic growth. In their works, they reflected on the Keynesian approach to economic history. However, this was not further developed afterwards and the 'new economic-historians' have taken on (to a greater degree) the ideas and methods of neoclassical theory. Yet any economic theory (having been 'overturned in the past') is necessarily subjected to an institutionalist interpretation (for example, *A Theory of Economic History* by D. Hicks first published in 1969). This work was written to demonstrate the positive capabilities of neoclassical theory (without mathematical methods). It argued that economic history (as a whole) cannot be interpreted without mentioning institutional innovation (Latov, 2004). North's works are a good example of the conscious use of institutional theory to create a whole picture of historical evolution essentially without cliometrics.

Third, it is possible to connect the economic theory used for historical analysis with economic-mathematical methods (area 3). It is this area that forms the core of modern cliometrics. The leader in this field is Fogel.⁴ North also worked on this paradigm. Since neoclassical theory forms the mainstream of modern economic theory, neoclassical ideas also dominate in cliometrics. However, nowadays, cliometric methods are also used by those economists who support other concepts

opposing neoclassical theory/' It is curious to note that an organic connection between economic theory and mathematical methods is not always possible in the case of cliometrics. Mathematical methods dominate and some draw little attention to economic theory.⁷

In this chapter, we shall consider two versions of institutional economic history - Fogel's and North's.⁸ The two differ in that while the supporters of cliometrics led by Fogel focus on new methods of economic-mathematical analysis for historians, North's followers emphasize the application of the conceptual apparatus (property rights, transaction costs etc.). Thus, North's economic history is institutional. However, Fogel's economic history is not immediately institutional but supposes an institutional interpretation.

2. D. North's Theory of Institutional Changes

Both North and Fogel started with cliometrical research into the transportation revolution and slavery in the 19th century US. In the 1970s, North attempted to develop a complete theory of a new economic history. His first experience with this macro-theory resulted in the book *The Rise of the Western World* co-written with R. Thomas (North and Thomas, 1973).

With respect to the concept of economic progress, North and Thomas based their work on A. Smith's ideas concerning the division of labor as a primary factor and a deep source of economic growth. In order to stimulate the development of division, premises such as investments and innovations are needed. However, why did investments and innovations play a large role only in a few cases? According to the authors, this depends on what the institutionalists understood as a set of rules adopted in society. Institutional structure is effective when it provides conditions for fast economic growth which, in turn, depends (first and foremost) on the property rights system (North and Thomas, 1973, p. 2). Focusing on changes in property rights over the history of society led North to study the long-term dynamics of activities related to protecting and enforcing property rights.

As effective institutions arise in society, providing many incentives for creating and enforcing property rights, the index of the potential capabilities of progressive development arises out of activity concerning the specification of property rights. For these reasons, North suggested dividing up all kinds of economic activity in the transformation sector, where the physical properties of products are changed (production of bread from grains or gas from petroleum), and the transaction sector. This served to specify property rights. He referred not only to the activities of civil servants (police, courts) but also to the wholesale and retail industries, insurance, banking, etc. in the transaction sector. Moreover, transaction services are also developed within the transformation sector (lawyers and accountants working for the firms that produce the material goods). Cliometric research (with J. Wallis) allowed North to demonstrate the expressed tendency for growth of scale within the transaction sector (both absolute and relative) (see Chapter 1.3, §7).

The new approach to understanding structural shifts in the economies of developed countries allowed North to continue (in his monograph *Structure and*

Change in Economic History, 1981) to reevaluate the classification of the main phases of societal development (supplied by D. Bell and his followers).

In the theory of the post-industrial society, as it is known, industrial, scientific and technical revolution are the main stakes of global socio-economic development. Instead of these revolutions, North highlights the first and second economic revolutions. The first revolution corresponds to the Neolithic revolution, which is essentially ignored by most supporters of post-industrial economics.⁹ And the second revolution is completely different from the industrial and technological revolutions. According to North, the industrial revolution is not a radical break with the past, but the culmination of past development. In his opinion, the original revolution began only in the mid-20th century. There was a systematic connection between production and science that included reinforcing the legal protection of innovation and competition (the laws on patent protection, trade secrets, etc.). North also states that, while the first economic revolution created agriculture and 'civilization', the second economic revolution supplied production with growing new knowledge by maintaining economic growth in a system as a result of the marriage of science and technology.

North's theory of a new economic history culminated in his monograph *Institutions, Institutional Change and Economic Performance*, which was published in 1990.

According to North, a new economic history convincingly demonstrates that it is not necessary to use cliometrics to develop the entire theory of economic history (North's theoretical works generally contain no formulas). It is necessary to conduct the dialogue (even polemic) with the tradition of the 'old' institutionalism. In his analysis of institutional changes, North connected both traditions.¹⁰ As the representative of a 'new' institutionalism, he emphasizes the major value of legal institutions and property rights. As a scientist, who has tested the influence of the 'old' institutionalism, he stresses the fact that both formal and informal limitations affect transaction costs.

Not all representatives of a new economic history could switch from studying separate problems of economic history to creating the theory of economic history. Only certain historians who (apart from North) demonstrated not only cliometric skills, but also theoretical thinking can also be considered economists: G. D. Snooks (1993; 1996; 1998), A. Greif (2002), D. McCloskey (1987). Their theory of economic history also acquired an institutional character.

In Russia, the first experience with a new economic history (in keeping with North's tradition) is S. Kovalev and Y. Latov's article (2000), which deals with the external effects of the feudal economy in pre-revolutionary Russia.

North's paradigm found very little support in Russia probably as a result of the fact that it requires a combination of historical knowledge and an in-depth knowledge of economic theory. But that is not absolutely typical for post-Soviet historians.

The definition of institutions as conscious and/or spontaneous combined rules of game results in the problem: why do these rules vary? Those who support a new economic history focus on the conscious choice of norms and institutional design

as well as the export of institutions. But there is also another component to the problem of institutional variability: institutional inertia.

§2: The Path Dependence Theory as the Dependence on the Trajectory of Past Development

1. The Emergence of the Path Dependence Theory

Along with North's theory of a new economic history, there is also another (similar but independent) theoretical institutional approach to economic history, namely the Path Dependence Theory (1980s) whose fundamentals were developed by American economists/historians P. David and W. Brian Arthur.

In Russian literature, the expression 'Path Dependence Theory' is usually translated as 'Dependence on past development.'" David and Brian Arthur also drew attention to institutional changes and the role of institutions in the technical changes. However, while North's new economic history focuses on the revolutionary influence of legal innovations and institutional changes on socio-economic development, the Path Dependence Theory concentrates on the inertia of development. Thus, while North's followers study how institutional innovations became possible, the followers of David and Brian Arthur, on the contrary, study why institutional innovations are not always possible. Besides, while North pays more attention to property rights, David and Brian Arthur focus on the informal mechanisms of choice.

The history of the Path Dependence Theory began in 1985 when David published his article on such an 'insignificant' problem as the creation of the standard of keyboard.

The typewriter was invented in the US in 1868 and originally its keys were placed in two sets in which the letters from A to Z were represented sequentially. However, the first models of typewriters (produced by the firm Remington, starting in 1874) worked in such a manner that quickly pressing two keys caused them to jam. Then another version of the keyboard was invented, where the most frequently used alphabetic combinations were moved to different sides. In the middle of the 1870s, the QWERTY keyboard appeared and quickly became the standard. The QWERTY standard was invented by American C. Sholes who invented the typewriter. Thus, the QWERTY keyboard appeared under temporary and random technical circumstances. Two decades later, typewriters improved so that the jamming of keys became impossible, yet the QWERTY keyboard remained the exclusive standard.

The scientific study of the optimum principles of key arrangement led A. Dvorak (a follower of Taylorism) to patent a new keyboard. Although experiments demonstrated that Dvorak's keyboard is more effective than the QWERTY keyboard by 20-40 percent, the new standard was not adopted on a mass basis. Some felt that these experiments were biased and that the advantages of Dvorak's keyboard were illusory (Liebowitz and Margolis, 1990). However, supporters of

the new model say that, after it is installed in computers (within two months), typing speed increases noticeably. It is most interesting that Dvorak's keyboard is not perfect. Others developed even more effective models. Yet, despite all the innovations proposed, most people still use the QWERTY keyboard.

While looking into the interesting problem of why the ineffective standard has maintained a monopoly for half a century, David came up with even more intriguing circumstances. In the 1870s in the US there were effective keyboard arrangements that surpassed the QWERTY standard. Such variety all but disappeared by the turn of the 19th - 20th centuries. Soon, almost all producers adopted QWERTY-type keyboards.

The prevalence of QWERTY is explained by the action of spontaneous developmental processes of 'technical interrelatedness, economies of scale, and quasi-irreversibility of investments. They constitute the basic ingredients of what might be called QWERTY-nomics' (David, 1985, p. 334).

According to David, only one standard wins among a set of competing alternatives and returning to variety in standards becomes practically impossible. There is the so-called feedback effect. Brian Arthur referred to this phenomenon as a 'lock-in tendency' (1989; 1994),¹² or the 'lock-in effect', referring to when irreversible changes take place in only one direction. Thus, it is inevitable that one standard will dominate, although there is no objective regularity that this standard will be the best. 'Historical contingency' plays an important role, determining the sequence of all future events at the start of the process under investigation.

The history of the domination of the QWERTY keyboard over the more effective standards can be addressed in a context of a global economic history. The study of the economic history of technical standards (based on the works of David and Brian Arthur) demonstrated widespread QWERTY effects in almost all branches. Therefore, the problem (whether the QWERTY keyboard is actually worse than the Dvorak keyboard or the discovery of the QWERTY effect has resulted in the incorrect interpretation of actual historical circumstances) makes no sense at all.¹³

2. From QWERTY-nomics to the Economic Theory of Standards and to Alternate Economic History

In modern economic literature, the QWERTY effect refers to all kinds of rather ineffective, but stable standards that demonstrate that 'history does matter'. These effects can be detected in two ways:

- by comparing technical standards that coexist in the modern world; or
- by comparing actual technical innovations with innovations that are potentially possible, but have not been developed.

Although the modern economy is globalized and unified, different technical standards (which are not compatible with one another) continue to exist in different countries throughout the world. Some examples are well-known. For example, people in some countries drive on the right while motorists in others drive on the left, which forces manufacturers to install car steering wheels on the left and on the

right. Other examples are less well known, such as the difference in the gauge of a railway track or in the standards for the transmission of electricity.

Can QWERTY effects arise only at the early stages of economic history? No, they appeared during the period of the scientific and technical revolution. For example, the creation of standards for television equipment (a 550-linear standard in the US and an 800-linear standard in Europe), the adoption of the VHS videotape format (see Brian Arthur, 1990), the development of the software market (DOS/Windows victory over Macintosh) (see Liebowitz and Margolis, 2000) etc.

As for the comparison of the study of competition between different standards, economic history involves a little more speculative analysis. Many historians/economists are of the opinion that many technical innovations won as a result of tactical circumstances.

The idea of a comparison of implemented and potentially possible technological strategies was expressed for the first time in a book published in 1964: *Railroads and American Economic Growth* (Fogel, 1964).

The results of mathematical calculations were rather paradoxical: the contribution of railway construction was insignificant, equal to the GNP for a few months (in 1890, in the US, GNP might have risen approximately by 5 percent due to this factor)

The result of the broad debate is that Fogel took a sudden turn with respect to the field of research, switching from the problems of the transportation revolution to the economics of slavery and no longer focused on an 'alternate history'. But his experience did not go unnoticed. David and other 'QWERTY- economists' do not try to make a quantitative evaluation of the alternate technological strategies, but do make a broad qualitative comparison of an actual strategy with a potential one. Moreover, while Fogel acknowledged that the most effective version wins in actual fact, those who follow David suppose a victory of ineffective versions. Thus, after numerous studies on QWERTY effects, historians/economists discovered that many symbols of technical progress have become well known as a result of random circumstances and that we do not live in the best of worlds.

3. From QWERTY-nomics to Path Dependence Theory

The focus of new ideas in David's initial concept is that a victory of the initially selected standards/norms (not necessarily the most effective) can be seen not only in the history of technological development, but also in the history of the development of institutions. In 1990, many studies (including North's work) developed this premise - the QWERTY-approach. British scientist D. Puffert indicates that dependence on past development for institutions will probably be quite similar to dependence on past development for technologies as both are based on a high degree of adaptation to common practice, and any deviations will be too expensive (Puffert, 2003b; David, 1994).

While, in the description of a history of technical innovations one writes more often about QWERTY effects, within the framework of the analysis of institutional innovations others usually speak about path dependence, namely the dependence

on past development. However, both terms are sometimes used as synonyms. David defines path dependence as the dependence on the past development of a sequence of economic changes when the possible outcome can be influenced by remote events of the past, with random events (1985, p. 332).

In the history of the development of institutions, the evidence of dependence on past development can be traced at two levels: first, at the level of separate institutions (legal, organizational, political, etc.) and second at the level of institutional systems (especially, national economic systems).

Thus, any example of technological QWERTY effects necessarily has an institutional basis because it is not the technologies that compete but the organizations applying them (North, 1990, p. 122). Therefore, the dominance of a narrow-gauge track standard over the more effective wide-gauge track standard results from the dominance of Stenstrom's less effective firm (at least, with respect to a given criterion) over the more effective, but less successful competitors.

An interesting case of dependence on past development at the level of a separate group of institutions is demonstrated by R. La Porta and other advocates of a 'new comparative economic theory' (a new comparative economics). Comparing the influence of the systems of common (Anglo-Saxon) law and civil (continental) law on economic life, they convincingly prove the superiority of common-law tradition, which noticeably protects property rights (for example, the right of the small shareholders to protection against corporate managers) (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1998). However, these advantages do not cause countries with traditions of civil law (including Russia) to move toward a common-law system

In the historic-economic science, it is very common to focus on analyzing groups of countries with identical institutional inheritances instead of studying them separately. An example of this is A. Gerschenkron's theory of industrialization (see Chapter II. 1, §2.4) which states that the country's path of development is 'programmed' for centuries ahead. It depends on how the country came to capitalism. It could achieve capitalism independently (the first echelon), or through external influence which initiates internal sources of self-development (the second echelon), or capitalism remains a 'transplant from outside' (the third echelon). In the same respect, North worked at demonstrating a deep and difficult difference between the development of Latin America, which inherited institutions from undeveloped Spain, and North America, which developed under the influence of more advanced English institutions (North, 1990, chapter 12). Economists/transitologists also provide indications of a strong dependence on past development. They highlight very different results of similar economic reforms in Eastern Europe, post-Soviet states and the countries of the Far East.

While studies on QWERTY effects in the history of technology often highlight the choice of the 'locked-in' technology, the supporters of the Path Dependence Theory of institutional development place much less emphasis on this motive. Probably, the choice of institutions is different from the choice of technologies as a result of its more deliberate character.¹⁴ Both trends share a high degree of inertia

concerning past development that makes it impossible to switch between technologies and prevailing norms quickly.

3. Technical and Institutional Reasons for the Dependence on Past Development

The literature on path dependence stresses the plurality of the factors generating path dependence (see, for example, Puffert, 2003a). While those who developed the concept of QWERTY effects concentrated (in the neoclassical tradition) on the technical reasons for this phenomenon, North and other institutionalists focused on the social reasons connected with the activity of people.

David, the founder of the Path Dependence Theory, first referred to technical interdependence. Equipment systems (physical capital) and workers' skills (human capital) derive from a unified system consisting of complementary elements and it sometimes appears qualitatively impossible to update any separate element of this system. For example, in the case of the railway, there have been no changes from the time of the first railway, and we have continued to use a track model designed by G. Stephenson. The reason for this is that the track and the wheels of the rolling stock are elements of one system and when track or a piece of rolling stock wore out, it was replaced by equipment built in keeping with the old standard. Since all tracks and the entire park of rolling stock are never replaced simultaneously, the primary standard is maintained (irrespective of the lifespan of any part of the equipment). Brian Arthur and North interpreted this factor in institutional terms as the 'effect of coordination'.

The following factor is an increasing return of scale. Any standard is more expedient when it is applied often. Thus, when building new railways, the use of the old track standard facilitates the connection of new lines with the old. Therefore, new railways almost always use the same standards as those built earlier, even if the engineers acknowledge that the former model is obsolete. A similar phenomenon, with reference to institutions, is referred to as the network effect.

According to David, the simplest factor of dependence on past development is the durability of capital equipment (quasi-inconvertibility of investments). This explains why morally out-of-date capital (both physical and human) can be used, as major investments were involved. The duration of this effect is limited by the moral and physical depreciation of capital which must, nevertheless, be written off at some point. This factor also supposes a nontrivial institutional interpretation since the social capital can also be subjected to wear and tear. But it is more difficult to change social capital than physical capital. The constitution of the person (primary socialization) is completed in youth, and adaptation to varying conditions (secondary socialization) seldom changes the norms acquired in youth, namely values, stereotypes, and habits, qualitatively. Social capital (quasi-inconvertibility of primary socialization) lasts longer than capital equipment, as the average life expectancy of people exceeds that of equipment. Therefore, the successes of institutional innovation take place at an interval of approximately 10-

15 years after salutary changes to an educational system. Thus, the 'Japanese miracle' was organized when the generation of the people, wishing 'to be at war' in business instead of being involved into a conventional warfare, took the lead.

In the initial articles by David (about the QWERTY effect), his explanation was limited by these three factors. Brian Arthur provided an additional explanation concerning increasing returns of scale. He paid attention to the irregularity of increasing returns from the adaptation of new technologies. In other words, when the different technologies/institutions compete, the marginal utility of one version can increase faster than that of another. Yet a victory at early stages of competition makes it impossible to demonstrate the advantages of the alternate version. For example, when money and barter competed in Russia at the start of the 1990s, most firms benefited from barter at the outset. But when this institutional norm became dominant, it (literally) 'plugged' the reorganization capability of production.

In modern research into the reasons for the Path Dependence Theory, much attention is paid to cultural factors - mentality, education and public consent.¹⁵ Therefore, institutional economic history approaches evolutionary economic theory by studying routines, customs, etc.

§3: Economic History as a Global Competition of Institutions

The present stage of the development of economic-historical science, developing under the dominating influence of a new economic history, is characterized by the dominance of empirical research over the 'meta-theory'. This leads to a situation in which a large number of interesting and important studies into particular problems is the 'debris of a mosaic' and does not develop as a whole picture of historical evolution."¹ North came close to creating a new meta-theory, but his synthesis has not been completed yet. Obviously, the development of a new theory of economic history will require the association of the achievements of a 'new' and also the 'old' institutionalism.

The new meta-theory of economic history is called on to provide a synthesis of the best ideas of all these paradigms. The basis of such a synthesis can, in our opinion, become the treatment of economic development as a global competition of economic systems and institutions, when there is a choice - partly conscious, partly spontaneous - of the most effective means of the socio-economic development of humankind.¹⁷

1. Institutional Competition

Technical innovations, according to orthodox Marxist approaches, were considered the main 'driving force' in the development of society. In frameworks using an institutional paradigm, they are considered the result of institutional innovations generating a demand for new technologies and the emergence of the

conditions needed to introduce them into economic practice. However, it is possible that technical innovations have an inverse effect on economic institutions.

The main theoretical principle of a new approach is the thesis about competition as the main content of economic history. This competition is traced in two manners:

- competition of institutions ('rules of the game');
- competition of economic systems - the sets of institutions.

During the competitive choice, a great many norms and systems compete, partially in order to replace one another. During the course of this competition, those institutions and economic systems which are the most effective are chosen. One criterion for the efficiency of competing institutions and systems is their ability to increase the welfare of the people - welfare in the broadest sense of the word (not only material, but also intellectual; not only 'here and now', but also in a long-term respect).

The emergence of new institutions and economic systems can be an 'answer' to the 'challenge' of any external (natural) factors, but more often it is the result of the self-development of society.

Perfect institutions and economic systems can be selected in various ways - both unconsciously and consciously - with the application of violence (the less competitive institutions are destroyed during revolutions and backward systems perish in their struggle with more advanced ones) or in a peaceful manner (during economic reforms, the export of institutions and migration of resources). In the early phases of history, natural and violent competitive selection dominates, to be replaced by conscious and peaceful selection later. In an analogy to the theory of public choice and the problem of choosing the rules of decision-making, it is possible to speak about a competition of means of competitive choice as the highest level of competition in economic history.

It should be noted that (in keeping with the dependence on past development) the efficiency of institutions and systems can differ noticeably on a mid- and long-term basis. Therefore, norms and systems that initially win a competition can then lose their competitive potential and become deadlocked.

By virtue of the plurality of competing institutions and systems, the process of societal development is multi-linear:

- the different social systems compete (in particular, in the 20th century, the command industrial system with the market industrial system);
- the different civilizational and national systems compete (thus, in the 20th century - within a command system - Soviet, Chinese and Eastern- European sub-systems compete);
- within civilizational and national economic systems, various institutions compete (for example, in the 20th century in the US, direct, Keynesian, methods of economic regulation competed with indirect, neoclassical, ones).

Thus, economic history appears as a sequence of institutional choices - choices of development trajectories - and is achieved collectively by separate social groups and civilizations interacting with one another.

2. Institutional Choice

Institutional choice is a change in both formal and informal rules and also the means and efficiency of the enforcement of rules and limitations. The changes in formal rules (or in enforcement mechanisms) require rather significant costs in terms of resources that limit the capabilities of institutional choice. The economic subjects participate in institutional choice focusing their talents and knowledge on the search for new opportunities through establishing organizations (both final and intermediate) that act in economic and political areas, providing the required changes in formal rules. Economic changes to formal rules can occur rather quickly and suddenly if old institutions are broken down or temporarily neutralized (as happens during revolutions or conquests). More often, however, these changes occur in a slow, evolutionary way.

As for changes in informal rules, they are implemented gradually and the rate of change is very slow. Culture plays an important role in this case (as the mechanism for transferring values and norms from one generation to another), as do contingencies and natural selection.

Organizations play an important role in institutional changes. An organization (in the broadest sense) is a group of the people, integrated in order to achieve a shared purpose. Pursuing the purpose of income maximization, the organization and its managers direct institutional changes. There are two main strategies for change: one is implemented within the framework of an existing set of limitations and the other requires a change in limitations.

The process of change usually actuates organizational experiments, and eliminates organizational errors. The problem, however, is: to what extent does the company control these organizational changes and to what extent is it interested in the elimination of organizational errors?

The long-term economic changes are, as a rule, the result of the accumulation of a set of short-term decisions on the part of political and economic agents. The choice, which is made by the agents, reflects their subjective opinions about the world. Therefore, the degree of conformity between the results and intentions depends on the correctness of these opinions. Since the behavioral models of people reflect their ideas, philosophy, beliefs (that, at the best, are only partially subjected to correction and improvement by feedback), the consequences of conscious decision-making are frequently not only uncertain, but also unpredictable. Therefore, historical process always supposes alternatives, though in a different measure and in various periods.

Notes

¹ In the Soviet Union, this direction of cliometrics, connected with primary attention to the correlation between climatic and social shifts, was picked up by L. Gumilev (1966), and then, in post-Soviet Russia, it was continued by E. Kulpin's school of socio-natural history.

² As for the theory of long waves (not only Kondratiev's), a lot of work has been done both abroad and in Russia (since 1980). However, this problem remains debatable. Some scientists (such as A. Frank) find long waves in primitive history, others (such as S. Solomou) doubt the very existence of Kondratiev's cycles for recent centuries (Poletaev and Saveljeva, 1993; Solomou, 1987; Frank, 1992).

³ His book promotes, in Russia, the potential of the mathematical analysis of the primary historical data for processing information (Kovalchenko, 1987). One of his basic focuses in historical-mathematical research is studying regularities in the agrarian sector of the modern Russian economy. While studying the long-term dynamics of prices, he and his followers argued that, in pre-revolutionary Russia, there was a rather unified market for the main agricultural products, but the capital, labor and land markets developed much slower (see, for example: Kovalchenko and Milov, 1974). Under Kovalchenko's initiative, Russian-American symposiums have been conducted on cliometrics for historians since the end of the 1970s. Unfortunately, there is another domestic, popular version of quantitative history, which tends to discredit quantitative historical analysis. This is a 'new chronology' developed by A. Fomenko. It, too, is based on many relationships on quantitative methods for processing historical data (for example, on 'dynastic parallelisms'). The 'new chronology' has not only made a methodological error in the choice of the objects of historical-mathematical analysis, but also falsified the mathematical apparatus, when the solution is chosen before making analysis (see, for example: *Istorija i anti-istorija*, 2001).

⁴ The title of his article - 'Reunification of Economic History with Economic Theory' (Fogel, 1965) - is interesting.

According to North (1977), a new economic history is based on two cornerstones - neoclassical economics and quantitative methods.

Chapter II. 1

The Main Institutional Models of the Emergence and Development of Capitalism

Rustem Nureev

Institutional models of the emergence and development of capitalism arose in opposition to mainstream economic thinking. Therefore, before describing these concepts, we shall briefly analyze the widespread approaches to the problems of development in a modern economic science.

§1: Economic Determinism and Institutionalists' Criticism

The economic determinism existing in the modern economic science is represented by two basic approaches: economic liberalism in its neoclassical form and primitive Marxism. As the influence of the first approach dominates, we shall begin our analysis with it.

1. Shortcomings of Neoclassical Approach to Researching Development

The dignity of neoclassical economics turns into its defects as soon as it tries to analyze problems of development. In the late 20th century, neoclassicism became mainstream economic thinking and tried to analyze not only the modern state of the economy, but also to draw a deduction concerning the economic development of the market economy on basic principles. Since the behaviour of the individual is conditioned by his nature, trade is a natural property of a person, much like his ability to speak or to drink. Moreover, as a result of the sequence of methodological individualism, the development of society is the result of actions of individuals, from which we can determine 'natural' laws of development. As in the modern world, the economic area dominates and the social and political connections are considered derivatives of this sphere of activity; it would be naive to believe that material interests determined the development of society at all stages of human development. Since it is supposed that the economy always aims at attaining an equilibrium, the interference of the State is considered a disturbance with respect to efficiency as well as second best in comparison with the first which arises automatically under perfect competition. Under this type of approach even simple innovations lead to a disturbance in the equilibrium and fundamental scientific research is only possible through State financing, i.e. overcoming market failure.

The advocates of neoclassical economics opposed the sharp interference of the State in the economy. In their opinion, such an approach is based on a weak understanding of economic processes and leads to large political changes that are

not all always favorable for the economy. The classical liberal approach, on the contrary, proceeds from an in-depth analysis of current processes, analyzing tendencies in economic development and does not require intense political changes. It is intended to create favorable conditions for market development which promote the discovery of potentials and opportunities concerning human development.

Although this picture only seems simplified, it stems from basic mainstream methodological assumptions. Even those mainstream economists, who were especially engaged in the problems of economic history, have to overcome this simplified picture.¹

2. Marx's Approach and the Vulgarization of His Theory

It should not be forgotten that American and Western institutionalism developed as a response to the form of Marxism that existed in the late 19th and the first half of the 20th centuries. In retrospect, we can see that it was a certain parody of Marxism, although such a parody really existed and emerged not without the help of the followers of K. Marx.

The subject of Marx's research was material, socially organized, and historically conditioned production. He characterizes a mode of production as a dialectic unity of productive forces and production relations, with productive forces as a measure of the power of people over nature. According to Marx, mankind's first productive force is not the means of production, but the worker who has general and professional knowledge, know-how, and skills. He is a person with a wealth of abilities and creative possibilities. Marx qualitatively determines the various stages of the development of productive forces which occur inside and by means of production relations (natural productive forces, social productive forces, total productive forces). However, full understanding of these stages arose only at the end of the 20th century.² In the early 20th century, another concept was absolutely dominant. G. Plehanov's view was prevalent. He considered instruments of labor as the determining moment of productive forces.

Marx discovered not only independent contents of production relations as relations between the people dealing with production, distribution, exchange and consumption of material goods at different stages of the historical development of mankind, but also tried to show their qualitative distinction from both technological and legal relations. The particular difficulty lies in the differentiation of the economic and legal aspects in the relations of property, understanding the role and place of property rights in a system of production relations.

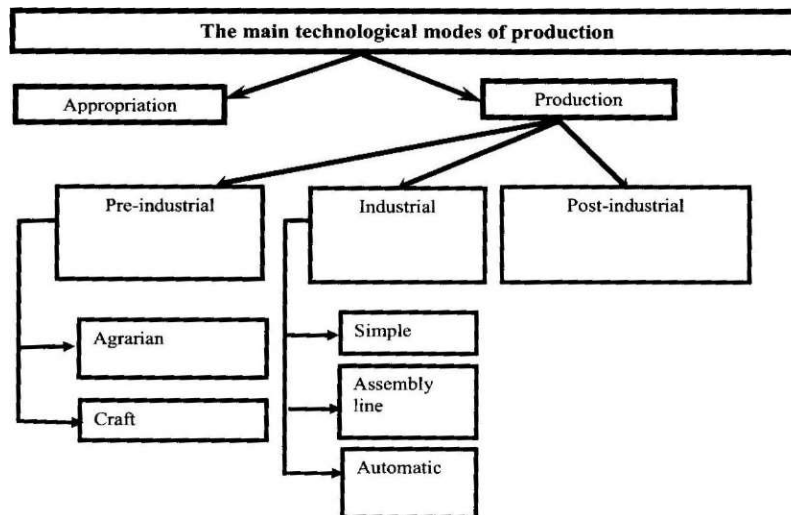


Figure II.1.1 Main technological modes of production

In Marxist political economy, the relations of ownership are discovered through a system of relations of production.

However, from the 1930s to the 1960s, J. Stalin's concept dominated. Namely, ownership was considered the basis of relations of production (then ownership was considered the initial and the main relation of the economic system).

Characterizing the structure of society, Marx marks four levels: productive forces - relations of production (as a base) - legal and political superstructure - forms of public consciousness.

K. Marx and F. Engels used the concept of 'mode of production' with a different meaning, including the technological mode of production (craft, manufacture, factory, industrial mode of production, etc., see Figure II.1.1) and the socio-economic mode of production (primitive-communal, Asiatic antique, feudal, bourgeois and communist mode of production).

This concept was developed before the 1860s-1870s. However, prior to this period, the more primitive concepts dominated; they were extremely close to economic determinism and were a 'narrow class approach', according to K. Polanyi. The misunderstanding of the dialectics of productive forces presented a difficult task for Marx's followers. According to Plehanov, the final reason for the development of productive forces is the geographical factor.³ According to Polanyi, 'the liberal economic outlook thus found powerful support in a narrow class theory. Upholding the viewpoint of opposing classes, liberals and Marxists stood for identical propositions' (1957a, p. 151).

The supporters of historical sociology (N. Elias, K. Polanyi) dealt with these concepts and decided to determine whether the role of the market economy is absolute and how it contains the sources of its origin in itself, as the advocates of neoclassical economics claimed. They try to determine the extent to which a self-regulating market is capable of arising on its own without external factors.

3. K. Polanyi's Criticism of Economic Determinism

N. Elias (1897-1990) was the first who pointed out the boundedness of economic determinism in relation to explaining the genesis of capitalism. He was a follower of M. Weber. In 1939, in his book *The Civilizing Process*, he wrote about the development of monopolies of power and stressed that only after a centralized and public monopoly on violence a competitive struggle for means and consumer goods could take place largely without the application of physical violence; only then a household (in a strong sense) took an economic dimension, and there arose a competitive struggle in the variety which we called 'competition' (Elias, 2000, p. 161 ff, 254). However, Elias's concept became popular only in the 1970s. The revolution in the concept concerning the genesis of capitalism was made by another scientist linked to the tradition of German sociology, K. Polanyi (1886-1964).

Table II.1.1 Principles of behavior in pre-industrial systems

<i>Principles</i>	<i>Reciprocity</i>	<i>Redistribution</i>	<i>Household</i>
Base model	Symmetry	Centralization	Autarchy
Field of action	Family	Company	Closed group (family, settlement or feudal holding)
Purpose	Reproduction of family	Reproduction of society	Reproduction of group
Connection	Related	Territorial	Related and territorial
Process regulator	Magic and traditional etiquette	Customs and law	Household head (according to tradition)
Exchange	Horizontal	Vertical	Mutual

Source: Polanyi, 1957a, Ch. 4

Polanyi investigated the emergence and development of capitalism in Western Europe from the 15th to mid-20th centuries. He understood market economy as 'self-regulating markets' (1957a, p. 57). Polanyi paid attention to an obvious contradiction which the advocates of neoclassical economics failed to notice. The existence of a self-regulating market is impossible without market laws. However, we cannot presume that market laws function as long as the existence of the self-regulating market has not been proven. This has given rise to a vicious circle and, as Polanyi stressed, neoclassical economics could find no way out of it. The attempt to deduce these laws from the nature of man was Utopian (Polanyi, 1957a, Ch. 9). That is why he compares the modern industrial economy with the pre-industrial one based on three main principles: reciprocity, redistribution and householding. Their contents are briefly summarized in Table II. 1.1. According to Polanyi, these principles were institutionalized with no help from the economy, but with the help of social organization (1957a, p. 47).

If we compare the market and the redistributive exchange of products (see Table II. 1.2), we shall see radical differences between the two. The methods of

coordination under a social division of labor differ in the pre-industrial and the industrial periods, as does the logic behind this development.

Polanyi's critique concerns the fact that isolated markets are never automatically transformed into a market economy and a regulated market is never automatically transformed into a self-regulating market. Such a process was not the result of the internal intrinsic tendency of markets. It was the outcome of social forces. 'It was not the coming of the machine as such but the invention of elaborate and therefore specific machinery and plant which completely changed the relationship of the merchant to production' (Polanyi, 1957a, pp.74-75).

Table II.1.2 Changes in methods of coordination

	<i>Redistributive product exchange</i>	<i>Market commodity exchange</i>
Societies in which it predominates	Pre-industrial	Industrial
Character of relations	Vertical (e.g., master – servant)	Horizontal (between the manufacturers)
Competition	Is eliminated	Is spread widely
Regulation	Centralized	Self-regulation
Role of money	Minor	Dominant
Type of exchange	Forced	Voluntary
Equivalence of exchange	Is not observed (only return)	Is observed at each sale and purchase

Considering the history of Speenhamland, Polanyi demonstrates how in the 18th century society opposed any attempts to transform man into a simple appendage to the market. The paradox of Speenhamland's Law led to the total pauperization of the rural population. Building up the labor reserve antedated the creation of the industrial army. '... "poor" and "pauper" sound much alike... "Poor" was thus practically synonymous with "common people"' (Polanyi, 1957a, p. 87). Society's intention to protect itself from the market economy failed (and even had the opposite effect), extending the period during which capitalism emerged.

It is possible to speak about the free market in England only in the period after 1834, when Speenhamland system was eliminated and *laissez-faire* spread. The free market relied on three principles: a competitive labor market, the gold standard system and the freedom of world trade. These principles, as Polanyi shows, become the parts of a united whole. But, even in this late period, 'the road to the free market was opened and kept opened by an enormous increase in continuous centrally organized and controlled interventionism' (1957a, p. 140). It is interesting to note that this situation lasted for 30-40 years. Already in the 1870s-1880s, we experienced a period during which orthodox liberalism was destroyed and a 'collectivist' countermovement appeared in all fields. As for labor, there were laws on trade unions and also factory legislation. In the agrarian sector, there was protectionism (agrarian tariffs and other measures to protect domestic agricultural production). The competitive markets transformed into monopolistic ones and an imperialistic tendency appeared in the external sphere. It is curious that the countermovement against economic liberalism has become a spontaneous response, which has developed in all developed countries, so that even the most

consecutive adherents of this doctrine could come to the realization that *laissez-faire* is incompatible with the conditions of the developed market society.

The gold standard was maintained for a long time. However, as a result of this, industrial enterprises and the economy as a whole functioned with great difficulty. The fact that the exchange rate was fixed implied a whole system of measures for maintaining currency stability. This would be impossible without an increase in national export. However, for colonial and dependent countries (with their monocultural specialization), any increase in national exports meant a fall in prices. Their attempts to refuse to repay debt payments inevitably affected external political interference. The paradox of this situation is that maintaining economic equilibrium required political measures.

The period of the late 19th and the early 20th centuries is characterized by the growth of the colonial system. The great powers struggled for trade privileges on politically protected markets. This resulted in the economic and political division of the world. Under these conditions self-regulating markets inevitably ended.

Polanyi's historical analysis of the emergence and development of capitalism demonstrates that if self-regulating markets existed, they did so for an extremely short period and furthermore the logic of the development of the free market has inevitably resulted in a completed crash, as seen during the Great Depression and the First and the Second World Wars.

In the 19th and 20th centuries, certain efforts were made with respect to the institutional analysis of the emergence and development of capitalism. We shall consider some of them.

§2: The Main Institutional Approaches to the Emergence and Development of Capitalism

Many institutional theories were influenced by the Marxist theory of the genesis of capitalism. Therefore, at first we shall describe the theory of the so-called primitive accumulation of capital.

1. The Theory of the So-called Primitive Accumulation of Capital

Marx defines capitalism as commodity production at the stage of development when labor becomes a commodity. Therefore, the primitive accumulation of capital is based on the formation of preconditions for capitalist relations and, first of all, the emergence of a new type of manufacturer, which is as free as an individual and has no means of production and subsistence. The appearance of the labor as a commodity meant the liquidation of both the personal and land dependence of peasants and the liberation of craftsmen from the guild system. In the 14th - 15th centuries, rigid forms of personal dependence were abolished in most Western European countries as the land dependence of peasants on the feudal lord was abolished in the 16th- 18th centuries.

The primitive accumulation of capital is a part of the early history of capitalism. It took place in the 'subsoil' of feudalism and by means of methods

distinguished from the accumulation of capital. This process was based on the bourgeois agrarian revolution. On the one hand, there was the mass appropriation of land from the peasantry and, on the other hand, feudal property was transformed, according to Marx, into 'pure private property



© 2004 Roman Zheleznyak. All rights reserved

The classical forms of the primitive accumulation of capital took place in England. Private ownership of land was enhanced and became stronger through the confiscation of the church and monastic possessions of the Roman Catholic Church, the acquisition of State land and the usurpation of common land, and the driving of peasants from their holdings. The land holding, created in this way, was rented to capitalist businessmen-farmers. Their position was strengthened by the 'price revolution' which resulted in the depreciation of the monetary payments

made by the farmer (rent to landlords and wages to workers). From the late 15th century to the early 18th century, legislation was enacted to cut wages and lengthen the work day. The extension of the market mechanism to land, money and labor resulted in assumptions concerning the development of the domestic market. However, the narrowness of this mechanism was not completely overcome during the period of manufacture (in Western Europe from the mid-16th to late 18 centuries). Only with the destruction of rural crafts (during the industrial revolution) was a stable domestic market formed, laying the groundwork for the development of capitalist means of production.

The genesis of capitalism in Western Europe was accelerated by great geographical discoveries, the creation of a world market, and the conquest of pre-capitalist societies in America, Asia and Africa. The development of world trade was promoted by the increasing role of merchants. Their interests were represented by the first school of political economies - mercantilism (16th - 18th centuries). Mercantilists were not passive observers; they actively worked to influence economic life with the help of the absolutist State. Absolutism resulted in an extensive bureaucracy and expanded regular army which also needed resources for covering huge expenditures. And though a main source of income for the absolute monarchy was a developed tax system, the nobility tended to increase monetary resources at the expense of foreign trade. Therefore, the trade bourgeoisie intended to present their point of view as the national interest. Protectionist policy has become the expression of the temporary union of nobility and trade bourgeoisie. However, this temporary union did not last long.

Regulations concerning the means of production, the standards and the authority of absolutism served to slow the development of capitalism. Works criticizing protectionism and promoting the principles of free trade were published.

The development of productive forces and the capitalist mode of production clashed with the narrow framework of the feudal system, with an absolute monarchy. In the mid-17th and 18th centuries the material preconditions for bourgeois revolutions arose.

Marx's *Das Kapital* contains no in-depth study of the development of capitalism although it does provide an outline of the historical tendency of capitalist accumulation. Marx pointed out three main stages in the development of capitalism. At the first stage, the worker's private ownership of his/her resources is the basis for small-scale production. Then, there arose social productive forces, followed by large-scale production. According to Marx, the destruction of individual and scattered means of production and their transformation into socially concentrated means of production was the prologue of the history of capital. This was followed by the concentration and centralization of capital and later by the international features of the capitalist mode of production. However, the concentration of production closely related to this stage, when the monopoly of capital fetters the further development of this mode of production. According to Marx, capitalist production generates (as a necessary part of the natural process) its own negation: 'It is the negation of negation' (1974, Part VIII, Ch. 32). This is the

general outline of capitalist perspectives according to Marx's work. Indeed, capitalism turned out to be a more enduring system than Marx had thought.

V. Lenin's attempt to concrete this analysis reflected only the situation as it existed from the late 19th to the early 20th centuries, and it is now a matter of history. Nowadays, there are many theories which attempt to overcome this limitation. Let us now consider one of them - the theory of regulation.

2. The Attempt to Modernize Marxism within the Theory of Regulation

The theory of regulation attempted to reduce the gap between the abstract theory of general equilibrium and simplified Marxism, on the one hand and the gap between the former and particular economic analysis of current economic problems on the other. These approaches were developed in the works of French economists in the 1970s-1990s (Aglietta, 1979; Boyer and Mistral, 1983; Lipiets, 1979; Boyer, 1986; Sapir, 1989, 2001; Boyer and Durand, 1993). They acknowledge that the general abstract neoclassical theory must be supplanted by Marxism and post-keynesianism. This will serve to supplement the neoclassical approach by the analysis of specific features, taking into account the time and place of events as well as their institutional forms. In this manner, these economists supported the mutual enrichment of history and economics.

On this basis, they take the various modes of production from Marxism and attempt to update them with allowances for time and place. In this respect, the major role is played by the concept of a mode of accumulation and also a precise configuration of institutional forms (money, employment relationships, forms of competition, the type of government, etc.). According to those who follow this theory, these institutional forms serve to make the general regulation concrete and define the regularities of its development. They are of the opinion that it is useless

to try to explain the necessity of the existence of economic institutes by one reason and that it is important to distinguish the origin and the viability of the economic institution precisely. The latter aspect is largely determined by the degree to which institutions complement one another. According to the advocates of the theory of regulation, markets need different institutions in order to be effective.

These French authors focused on the analysis of various crises (Figure II. 1.2). The gradual change in institutional forms, according to R. Boyer, is influenced by recurrent small crises. They are of two types. While the first type of crisis reflects the disturbance of external character, the second type reflects the partial disturbance in the regulation system. Small crises (whether early or late) lead to large (or structural) crises, which also are of two types. Thus, the third type of crisis is the crisis of the regulation system and the fourth type leads to the crisis not only the regulation system, but also to the mode of accumulation.

The comparison of the crises of 1929-1933 and the mid-1970s results in the idea that the last crisis is not simply the next crisis, but also a crisis of Fordistic system of employment, that essentially prepares for a new trend of development. The analysis of crises does not imply a completely negative attitude with respect to an existing economic system. Those who support the theory of regulation are of the opinion that the existing system has not yet lived up to its capabilities and that in order to develop successfully it must reveal and distribute new organizational forms and also requires more active State interference in the economy.

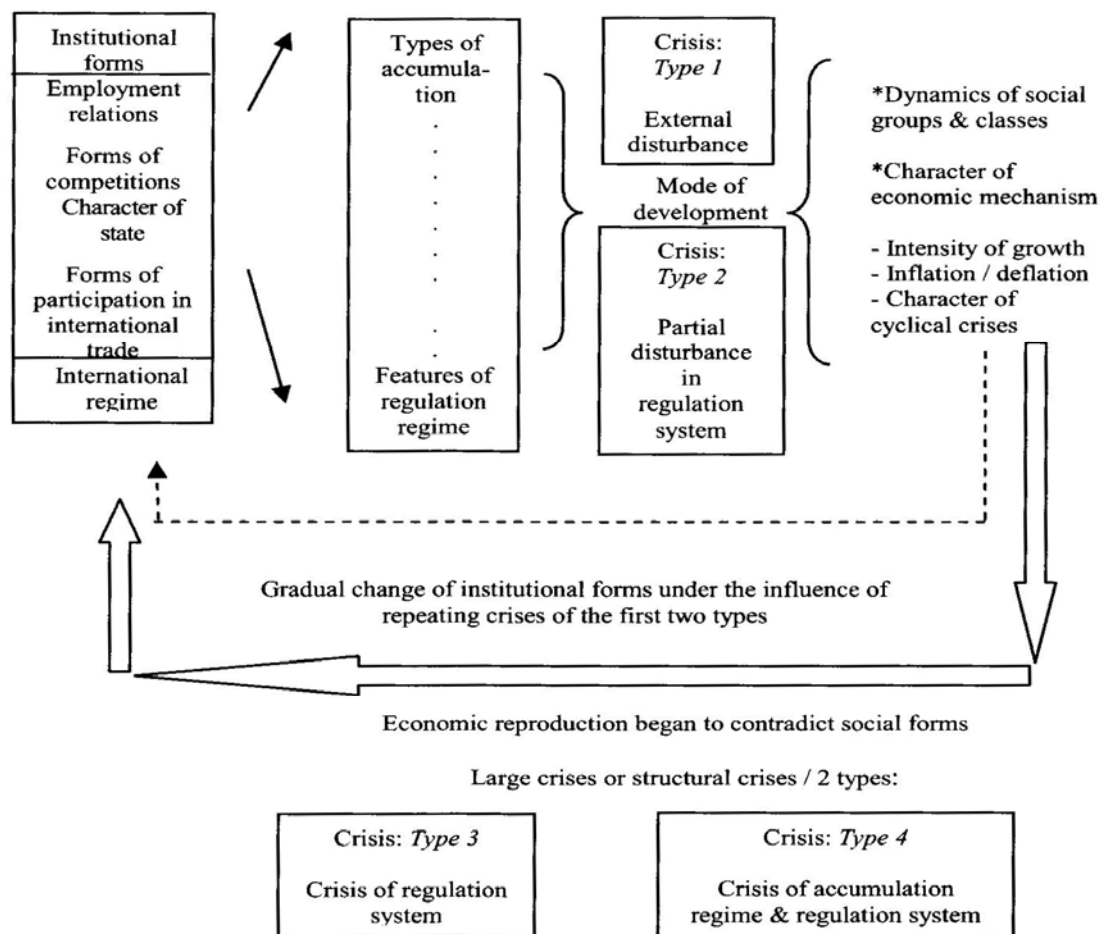


Figure II.1.2 The correlation of various categories: institutional forms, modes of accumulation, mechanisms of regulation and crises

At the same time, the theory of regulation has its own shortcomings. The lack of a single method of research results in the existence of various treatments of such concepts as the term 'regulation'. The term 'regulation' means the reproduction of a specific structure of society as a whole, and the process of the mutual adaptation of production and social demand (Aglietta, 1979; Boyer, 1979), and the aggregate of processes influencing the distribution of the factors of production, their consumption and income distribution (Benassy, Boyer and Gelpi, 1979), and the process by which a set of human actions are tailored to certain rules or norms (Lipietz, 1979) etc. As this research program has matured, the methods have become more diverse and the issue is not only the evolution of regulation modes but the diversity of capitalisms. This trend has given the impression that the theory was only descriptive. But recent works suggest that regulation theory is part of the active field of institutional economics, with explicit theoretical objectives.

3. *Post-Industrial Theory*

Other attempts have been made to correct neoclassical theories. The fact is that their classification of economic systems is extremely poor. They absolutize the present time in the most universal (American) form. As a criterion, they usually use the 'command - mixed - market economy' axis or forms of ownership and mechanisms of regulation. Therefore, there is no single criterion of division which is necessary for this classification.

Those who represent the futurological direction taken in this stream of research tried to supplement the existing picture (Galbraith, 1969; Bell, 1973; Toffler, 2001, 2002, 2003; Castells, 2000; Fukuyama, 2003; Inozemtsev, 1999, etc.). The historical classification of economic systems must include the past and future systems in addition to the modern system. One classification proposed by proponents of the post-industrial theory deserves special attention. They highlight pre-industrial, industrial and post-industrial economic systems (see Table II. 1.3).

The boundaries of these economic systems are industrial, scientific and technical revolutions. Within these systems a more detailed typology is possible, providing means for synthesizing formational and civilizational approaches.

Moreover, while one highlights only market capitalism, market socialism and planned socialism within a traditional classification of economic systems, the modern approach to economic systems draws attention to a system of internal rules and organizational structure.

Table II. 1.3 Classification of economic systems in a post-industrial paradigm

Economic systems	Pre-industrial	Industrial	Post-industrial
Main sector of economy	Agriculture	Industry	Services
Limiting factor	Land	Capital	Information
Prevailing social group	Land-owners	Capital-owners	Information-owners

During a scientific and technical revolution, science is transformed into a direct productive force. Although, following a neolithic revolution, there was a post-

appropriative - producing economy, based on agriculture, the result of the industrial revolution was a post-agrarian economy, originally based on light industry and later on heavy industry. During the scientific-technological revolution, a post-industrial economy arose. Now, the non-productive sphere has become a new center. By the end of the 20th century, nearly 1/3 of the US population worked in the service sector. Although land was crucial in an agrarian economy, capital was essential to an industrial economy, and information and accumulated knowledge become the limiting factor in the modern economy.

In his work D. Bell recognizes the importance of scientific and, primarily, theoretical knowledge (1980; 1988). The outcome of scientific activity is the revolution in telecommunications. Although in the 19th and the first half of the 20th centuries, the main forms of communication were newspapers, journals, books, and then the telephone, telegraph, radio and television, these have now all been replaced by computer communications. Knowledge and information have turned out to be strategic resources. First and foremost, this has resulted in essential changes in the territorial allocation of productive forces. In the pre-industrial period, towns grew along the intersections of trade paths; in the industrial period, they were developed near sources of raw materials and energy; and the technopolises of the post-industrial period grow around science centres and large research laboratories.

In the developed countries, purely material production has declined and the 'knowledge industry' has grown at the same time. Today the basis for the future society arises outside material production.

Thus, the development of the economy itself generated ontological assumptions with respect to building up a post-industrial paradigm as a component of world civilization. At the same time, it is obvious that this does not apply to a great many countries (including Russia). There is the area of manual labor, low-skilled labor, and outdated technology. That is why the industrial values remain attractive. This should be taken into account particularly because they were formed non-uniformly in the different parts of the globe.

4. The Concept of the Three Paths toward Industrialization

Although the concept of post-industrial society serves to track only the long-term tendencies of evolution, it is more reasonable to use other concepts, one of which is A. Gerschenkron's theory concerning the typology of industrialization process (1962)⁴ in order to understand regularities in middle-term development.

Gerschenkron refers to the elements of economic backwardness and demonstrates different paths toward industrialization, which allows us to separate out three echelons in the development of global capitalism. The first echelon (Western Europe and Northern America) is characterized by a lengthy spontaneous development of the premises of capitalism. Here, the main role is played by the private sector, which is encouraged by the State. Gerschenkron does not exaggerate the role of automatically self-regulating markets. However, the long-term development of the first echelon served to generate premises of the market economy gradually, step by step.

According to Gerschenkron, for the second echelon (Eastern Europe, Russia, Turkey and Japan), history has not provided a lot of time. These countries had to catch up with the countries-leaders. Therefore, these countries developed not only under the influence of an internal impulse, but also under the influence of the first echelon, because it held a leading position in the world. Here, the State played a major role.

Table II.1.4 Echelons of the development of world capitalism

Echelons	Country, region	Features of the development of capitalism	Role of the State in the economy	Place in the world capitalist system
1 st (since the 14 th)	Western Europe, Northern America	Long spontaneous development	Noticeable	Supreme
2 nd (late 18 th -mid-19 th)	East Europe, Russia, Turkey, Japan	Development is squeezed, dependent on internal and external impulses	Considerable	Secondary
3 rd (late 19 th -late 20 th)	Colonial and dependent periphery	Non-organic capitalist development, reaction of rejection	Dominant	Total dependency

The third echelon (the colonial and dependency periphery, the countries of Asia and Africa) is characterized by non-organic capitalist development. These States try to overtake other developed countries. Their private companies turned out to be poorer than those in Western Europe and North America. That is why the State helps them. Moreover, the functions and the role of the State increased. However, even State participation did not compensate for the gap between advanced and developing countries and backward positions in the world market (Table II. 1.4).

5. Myrdal's Concept of 'Asian Drama'

G. Myrdal (1898-1987) published his monograph *Asian Drama: An Inquiry into the Poverty of Nations* in 1968 in New York. The subtitle of this work is obviously a reminder of an inner polemic with A. Smith. The author highlights the contrast between the subjects of research by the scientists studying the problems of the 'third world' and the founders of political economy, examining capitalist development in Western Europe. He analyses the countries of Southern and South-Eastern Asia (India, Pakistan, Sri-Lanka, Burma, Thailand, Malaysia, the Philippines, Indonesia).

The concept of 'drama' appeared non-arbitrarily. It reflected both the objective development of the developing countries and the subjective understanding of the problems of the 'third world'. The demographic explosion was accompanied by a declining standard of living in some developing countries. This coincided with a crisis of hopes concerning the rapid transformation of the traditional society and disappointment with neokeynesian and neoclassical theories. Underdevelopment played a role in the drama, in which the central figures were, according to Myrdal, the nations of Southern Asia and, above all, intellectuals. It was the intellectuals who realized the scope of the gap between Western and Eastern societies. They had to work out a strategy and tactics for resolving difficult practical problems. Moreover, they took a critical approach to cultural inheritance and national traditions.⁵ This situation was aggravated by the fact that after the liberation they had to fulfill their progressive mission as soon as possible.

Myrdal's research begins with sharp criticism of the Western approach to the analysis of the 'third world'. Its methodological mistakes arise out of the fact that it attempts to transfer the realities of the developed society to the underdeveloped society. In practice, this leads to the creation of an enclave economy - the narrow sector of Europeanizing industry, which is more closely tied to the external rather than the internal market. Making investments in the priority branches was much easier than carrying out universal transformations of the economy as a whole. The industrialization policy did not result in essential positive outcomes, which might have changed the standard of living of the poor population. That is why we can see criticism of the basic categories of the growth theories: engineering (as the decisive factor of underdevelopment); the market (as a self-regulatory unit of economic development); planning (as the means of resolving social problems). Indeed, these factors serve to strengthen technological dependency and economic disintegration while increasing corruption and red tape.

Myrdal does not absolutize Asian values. Their main features are: the representatives of this region are more religious and non-aggressive; they appreciate moral values. However, according to Myrdal, they consider the straight-laced behaviour a virtue. Moreover, many of these Asian values characterize a stagnant society and contradict the ideals of modernization. Religion protects traditional socio-economic stratification and acts as a special force of social inertia. Therefore, the criticism of traditional society conflicts with religious values.

Myrdal criticizes ideological motives of the Western approach to economic development. This approach exaggerates the problem of employment, considers only a quantity approach to labor and views any unemployment as 'involuntary'. Many Western experts believe that in order to resolve the problem of 'excess of labor' it is only necessary to grant activities. Myrdal draws attention to the fact that, during the colonial period, there was a problem of a labor deficit and non-economic labor enforcement was widely practiced. According to Myrdal, the main reasons for that were: food shortages and bad health, a low standard of living, institutional conditions and the imperfection of the labor market. He claims that the Keynesian approach does not apply to most of the population. In India, only 13 million people (of an economically active population of 147 million) play a role in the modern sector!

The evaluations of unemployment levels in developing countries are rather conditional. Only the people with higher education are registered. As Myrdal stresses, most of the so-called unemployed cannot work in a modern sector and do not form a labor reserve in the socio-economic sense of this expression. Moreover the labor reserves depend on policy: as direct (education, propaganda, regulation and enforcement), and indirect (improving working conditions at the expense of other resources - capital and land).

Myrdal polemizes with S. Kuznets, who examined industrialization of developed countries and deduced a specific correlation between inequality and income per capita in GNP. The Kuznets curve shows that, at early stages of industrialization, the share of the poor population in the national income is reduced and the Gini coefficient rose to 0.6 - 0.7 (at the end of industrialization). This means the growth in the polarity of rich and poor. Myrdal defends the opposite approach. He is of the opinion that inequality must decrease to ensure the economic growth of the underdeveloped countries.

In order to overcome backwardness, according to Myrdal, the system of compensation for labor costs must be changed. Therefore, the main problem is not an increase in the rate of accumulation, but an increase in the supply of a food level that stimulates a more productive labor force. The reforms did not affect the radical bases of traditional society. It needs more in-depth agrarian reform. However, the tragedy is that the mind-set of the peasantry (in developing countries) turned out to be obviously unprepared for such reform. Therefore, Myrdal supports any social forces, which are already capable of ensuring an actual increase in labor contribution. He especially promotes such methods which, when applied, do not serve to increase the deficit of other factors of production. In particular, he proposes an entire program for developing local crafts.

Myrdal's approach had important humanistic significance. In essence, he 'identified' the big gap between the neoclassical and neo-Keynesian growth models and institutional development theory. Development, from his point of view, is the growth of the satisfaction of the needs of all members of society.

Under the influence of the institutionalists, he developed the Human Development Index. It is based on three indicators: longevity, as measured by life expectancy at birth; educational attainment, as measured by a combination of adult literacy (two-thirds weight) and combined primary, secondary and tertiary enrolment ratios (one-third weight); standard of living, as measured by real GDP per capita (PPP\$). The following indicators were used to construct this index:

1. Life expectancy at birth: 25-85 years;
2. Adult literacy: 0 to 100 percent;
3. Combined gross enrolment ratio: 0 to 100 percent;
4. Real GDP per capita (PPP\$): \$100 to \$40,000 (PPP\$).

$$W(y) \begin{cases} = y^* & \text{for } 0 < y < y^*, \\ = y^* + 2[(y-y^*)^{1/2}] & \text{for } y^* \leq y \leq 2y^*, \\ = y^* + 2(y^{*1/2}) + 3[(y-2y^*)^{1/3}] & \text{for } 2y^* \leq y \leq 3y^*, \\ = y^* + 2(y^{*1/2}) + 3[(y-2y^*)^{1/3}] + n\{[1-(n-1)y^*]\}^{1/n} & \text{for } (n-1)y^* \leq y \leq ny^* \end{cases}$$

The given index is estimated in keeping with the Atkinson index of income utility:

where y^* - the world average income (PPP\$) as the threshold level; in 1994 it was about \$5,835. Since 1990, the UN has published this index annually.

However, it then became clear that institutional factors play an important role not only in formal, but also in informal sectors of the economy and that this role increases in accordance with the transition to the market economy. While Myrdal analyzed the assumptions concerning the genesis of capitalism in formal sectors of the economy, H. de Soto examined them in informal sectors.

5. De Soto: *The Role of Informal Business*

In 1989, Peruvian economist H. de Soto published his book, *The Other Path: The Invisible Revolution in the Third World*, which became a best-seller in the 1990s. De Soto considers the evolution of informal forms of activity, demonstrating their significance in the 'bottom-top' emergence of a market economy and in building up a truly competitive environment.⁶

The book contains two parts: empirical and theoretical. In the empirical part, de Soto considers three spheres of informal activity (housing construction, trading and transportation), which promoted the solution of urbanization problems in Peru. De Soto points out that in the mid-1980s nearly half of Peru's labor force functioned in the informal sector, producing 40 percent of the total national output. From 1940 to 1981, the urban population in this country grew constantly (from 35 to 65 percent). It is important to note that if there were no informal sector, the major urban problems would not be resolved.

The fact is that, in terms of mass urbanization in the country, the authorities were not able to provide migrants with housing and migrants had to be employed in the informal sector. Step by step, de Soto shows how the people occupy the land and soon informal housing construction becomes formal. This type of approach is very convenient for people with low levels of income, protects city from being transformed into slums, and also promotes and enhances private ownership.

First of all, the high transaction costs of the primary legalization and of remaining formal prevent the free development of market relations. De Soto's book conflicts with traditional evaluations of informal and informal business in the 'third world'. Recently, it has been argued that only the formal sector promoted the modern economic culture. De Soto demonstrated that the formal economy of developing countries was entangled in merchantilist nets, and that the informal

sector promoted democratic economic order, building up private enterprise on principles of free competitiveness. This resulted in a kind of a vicious circle: the growth of the informal sector led to a decline of the formal one. However, the rise in taxes on formal business serves to increase the attractiveness of the informal sector. Taxes on formal activity apply to large formal businesses: it is impossible to hide activity from State tax administration. However, as this sector is the main source of income for the State, it (using political lobbying) seeks to reduce the tax burden, to obtain various economic privileges and tax concessions. If this tactic is successful, competition will be limited. As a result, the efficiency of the formal sector will decrease and the gap between the formal and the competitive informal economy will increase.

De Soto's work proposed a new direction for neo-institutional research - law and economics of development.⁷ He highlighted informal activity as a strong factor that can bring about improvements in the institutions of the developing country.

In 2000, de Soto's next book *The Mystery of Capital*, in which the author tries to solve five mysteries, was published:

1. mystery of the missing information;
2. mystery of capital;
3. mystery of political awareness;
4. missing lessons of US history;
5. mystery of legal failure: why property law does not work outside the west.

De Soto supposes that, in developing countries, a significant portion of accumulated capital is not capitalized. Although assets lead a double life in the West - not only are they used immediately for economic needs, but they are also a source of capital (for obtaining credit) - in the third world they do not fulfill this second function. Thus, de Soto selects six effects of private property (2000, Chapter 3):

- fixing of the economic potential of assets;
- integrating dispersed information into one system;
- making people accountable;
- making assets fungible;
- networking people; and
- protecting transactions.

The dissociation of most of the population from these six positive effects of private property leads to marginalization in society. The government should change the laws and the system of property so as to stimulate the division of labor. If this does not happen, the scale of informal economy will be larger. De Soto's concept has a number of visible shortcomings. Property is not only a transfer mechanism. Property is not only an assumption concerning the development of the market economy, but is also its outcome. Therefore, the backwardness of property relations reflects the backwardness of economic and social relations in developing countries.

Certainly, we are far from the legal fetishism of de Soto's concept. But we agree with the author that, without the transformation of the system of traditional institutions, norms and values a modern market economy cannot be developed. It is important not only to enact the good laws, but also to develop the enforcement

mechanism so that new institutes can function and to persuade common people to refer to them in everyday life

We shall now consider the views of left-wing radicals. They demonstrated that many internal factors of developing countries were affected by external factors. A less-developed economy results from the dependency and the dependency is also the result of a less-developed economy. In order to reveal the reasons for the origin of this phenomenon, they focused on history. Many works have been published examining the origin of the modern capitalist world economy, including, for example, works by Wallerstein, Frank, and Brodel. Frank's monograph *World Accumulation 1492-1789* was published in 1978. In it, he attempted to provide a historical sketch of capital accumulation during three centuries (from the discovery of America to the Great French revolution) and to analyze the historical origins of inequality in the modern world. The main idea is that the backwardness of the developing countries is determined by their position in the world capitalist economy: they are dependent and subordinate partners. The world market penetrates into these areas, where we can see the world dualism. The peripheral capitalism is infected with an 'inferiority complex' and thus loses the ability to develop independently. According to Frank, this concerns not only the strengthening of dependency, but also the 'development of underdevelopedness' as a result of the export of the foreign capital into colonial and dependent countries. M. Wallerstein continues to develop this idea

The idea about strengthening asymmetric interdependency was originally discussed by Wallerstein (1979; 2001; 2003). According to his concept, since the very beginning capitalism has been a phenomenon of world economy ('capitalist world-economy'). He stressed that this is the system of world connections based on trading. It was developed approximately in the 16th century.

Originally, the unified world was built up using violent methods. During the 17th and 18th centuries the leading role in the world economy passed from the feudal empires (Portugal, Spain) to bourgeois countries (Holland, France, England). Each metropolitan country behaved differently. They differed with respect to the degree of their involvement in their colonies and the extent to which they promoted the resolution of economic problems. Colonial policy varied from place to place. Metropolitan countries saw their colonies as markets for their industry, as sources of cheap raw materials, and as sources of taxes

Colonialism was a bloody, but rather effective way of involving the peripheral countries in a unified world system of economy. After liberation, the position of the former colonial countries within a world market system remains invariable. Moreover, economic dependency continues to increase.

In the 20th century, we observed some separation of the developed countries and less-developed ones as a result of active and sometimes successful attempts on the part of the less-developed countries to become active participants in the world economy. The most successful illustration is Japan which has moved (over a century) from being a closed country, situated on the periphery of the civilized world, to a country with an open economy included in the world economy. Other less-developed countries have also made progress. For example, per capita income growth, low inequality, and reduction in poverty were achieved by the 'high-performing East Asian economies': Hong Kong, Indonesia, the Republic of

Korea, Malaysia, Singapore, Taiwan, Thailand. It should be noted that one of the surprising features of the modern world economy is that resource-poor economies often outperform resource-rich countries in economic growth.

Apart from the relationships between 'nucleus' and 'periphery' there is the struggle between the developed countries for superiority in the world economy (Figure II. 1.3). As for world trade, in the 17th century Holland played the leading role, in the 19th century Great Britain did, and in the 20th century the US did. The intervals between the periods of hegemony were filled with economic and political antagonism between the economically strongest countries (Anglo-French wars in the 18th century, the world wars in the 20th century). In the modern world, there is a polycentric structure: the US, the European Union, Japan, the 'new industrial countries'. It is difficult to say whether this polycentric structure indicates a temporary period before the takeoff of a new hegemony or whether the position of hegemonists in the world economy will be relegated to the past.

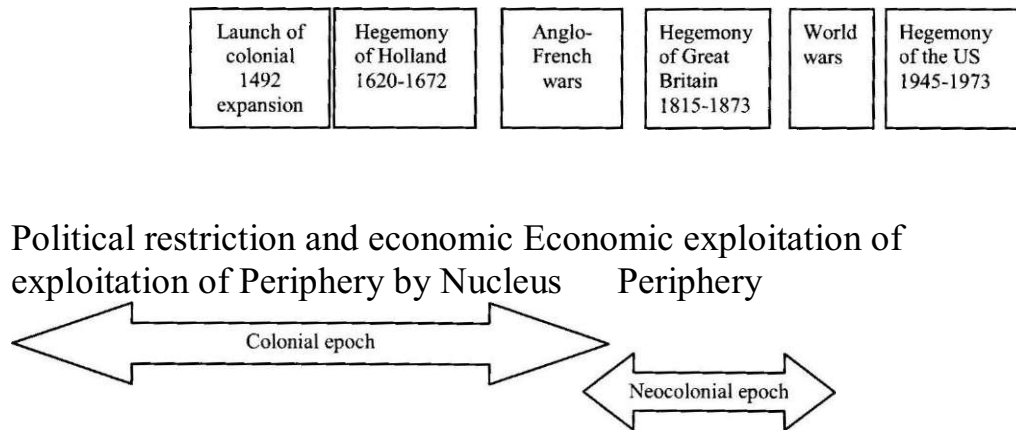


Figure II.1.3 Evolution of the world capitalist economy during the 15th-20th centuries

The world-system approach helped elaborate assumptions concerning the origin and development of institutional theories formulated by the representatives of developing countries: R. Prebisch's concept of 'peripheral economy', G. Amin's concept of 'dependency development', the concept of 'support on own forces', a 'new world order', and others. They played an important role in emerging self-consciousness and the evolution of scientific thought in the third world.

To conclude, the analysis of institutional models has demonstrated that capitalist development includes not only an economic subsystem, but also the broad spectrum of non-economic variables, including formal and informal institutions, culture and all systems of values without which a full evaluation of development is impossible (Figure II. 1.4).

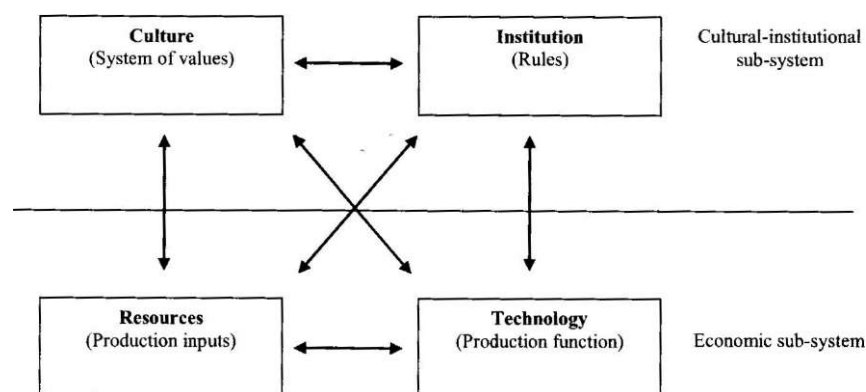


Figure II.1.4 Interconnected development in a social system

Source: Hayami, 1997, p. 11

Notes

¹ See, for example, the best known book of J. Hicks (2003).

² See, for example, the works by R. Nureev (1989, Ch. 2, 3, 6, 7).

³ According to G. Plehanov, the development of productive forces itself is determined by properties of geographical environment in which the people live (1956, p. 689).

⁴ The first publication (in our country) concerning the concept of the 'three echelons of development' was the work of I. Pantin, E. Plimak and V. Horos (1986, pp. 31-53).

⁵ According to J. Nehru (1955), the past always with us, and all that we present by ourselves, everything that we have, proceeds from the past.

⁶ For a more detailed review of de Soto's works and his contribution into the concept of informal economy see: Latov, 1999.

See a review of the recent developments in law and economics of development in Buscaglia, 1999