

NEO-INSTITUTIONAL ECONOMICS AND INDUSTRIALIZATION OF DEVELOPING COUNTRIES

Halil SEYIDOGLU*

Introduction

Despite the significant advances in the techniques of analysis, the neoclassical economics has become less adequate for the solution of problems that we face after the Second World War. In fact, to understand true nature of problems like rapidly changing technology, multinational corporations, inflation and unemployment (Stagflation), energy crises and international economic institutions within the narrow context of neo classical economics does not seem very promising.

There is no doubt that conventional economics of the Marshallian Keynesian type has provided us many useful tools to cope with many problems. But the neoclassical paradigm is mainly concerned with a self-contained and self-regulating economic model which always ends up with equilibrium. Therefore, it does not give us a true picture of a dynamic and evolving economic system which is characterized by disequilibrium.

An economic system does not consist of price mechanism and market forces only. In fact, these elements may be important but to gain a true understanding of a; economy it is necessary to go beyond the market forces and inquire into the non-market forces, like social and cultural milieu and institutional structure.

After the Second World War, tremendous technical changes occurred which are related to a rapid institutional change in the society. Big business corporations became prevalent in many aspects of our everyday life. Besides, they became multi-nationalized and carried their production processes to a wide range of countries.

* Visiting Professor of Economics at the Department of Agricultural and Applied Economics, University of Minnesota.

On the international scene many developments took place. The Bretton Woods system after working satisfactorily up to the late 1950's, caused serious crises in the 1960's and 1970's and finally was demolished in 1973 after the major currencies of the world were left to fluctuate. Meanwhile, several integration attempts were made by both developed and developing countries and the most successful of these efforts has been the establishment of the European Economic Community (EEC). The EEC has brought new dimensions to international economic relations between individual countries or groups of countries.

In the early 1970's the developing countries came to play a more active role in international arena. They organized several groupings through which they defended their own views with respect to international economic and political matters. Through what is known as the North/South dialogue, they are trying to establish a new international economic order responding more fully to their industrialization efforts.

These kinds of developments in domestic or international economics can hardly be explained within the narrow scope of mainstream economics. Therefore, orthodoxy in economic thought came under severe attack after the Second World War. As a matter of fact, dissention with the neoclassical economics has a longer history. Institutional economists like John R. Commons, Wesley C. Mitchell, John M. Clark and Walton H. Hamilton working in the tradition of Thorstein Veblen in the 1930's criticized severely the validity of the neoclassical economics. More recently, after the Second World War, Gunnar Myrdal, Clarence Ayres, Adolph Lowe, Gerhard Colm and Francois Perroux have been the main representatives of heterodoxy in economics. But, in contrast to the old institutionalists who preceded them they are called neoinstitutionalists.

In this paper we will try to explain the main ideas of neoinstitutionalist economics, point out the differences from neoclassical economics and indicate the essential features of institutional development economics.

Economics after Keynes

Economic and political developments have always

had a profound impact on economic thought. Keynesian economics is not an exception. It was mainly a response to the world Great Depression of 1929. Keynes fashioned his economic theory in the light of the economic facts of that time. He was mainly concerned with the problems of unemployment and indicated the kinds of policies to be adopted in order to cope with economic instability. Since unemployment was the dominant problem, he was not much concerned with problems like the role of technical change, large business corporations, industrialization of underdeveloped countries or efficiency in resource allocation. Hence, he made contributions only in a limited area of economics.

After the Second World War, the old Marginalist theory of Marshall and income theory of Keynes were combined. Thus, we were provided with a "neoclassical" synthesis. This new tendency dominated the circles of academics, business and government and prevailed in the textbooks of economics. (1).

But the neoclassical synthesis had its own defects. Both Marshall and Keynes were not concerned with the problems of the type that appeared in the Post-War period. They focused on short-run stability problems. Long-run problems like dynamic change, the structure and functioning of modern industrial economy and the role of big business in creating new human wants in the system were not their concern. These were the kinds of problems raised by neoinstitutionalist economists.

Post-Keynesians mainly dealt with gap analysis, namely to fill the gap between actual and potential total output levels of the economy and to prevent inflation once full employment is reached.

Another characteristic of economics in this period is the extensive use of mathematics as scientific tools of inquiry. In fact, great advances were achieved in econometric models, input-output analysis and operations research.

(1) Allan G. Gruchy, Contemporary Economic Thought, New York: Macmillan, 1972, p. 8.

As a matter of fact, mathematical and econometric techniques can successfully be used as long as the economy is in equilibrium or it tends to move towards an equilibrium. Therefore, this technique may prove very useful in showing structural and functional relationships of the economic system in the short-run. Furthermore, the development of mathematical and econometric techniques when coupled with rapid progress in electronic computers, made possible to analyze large amounts of data in a very short period of time. This would enable the industrial executive manager or government administrator to uncover many significant interactions among a great many variables. Thus, it will further the improvement management science and increase efficiency in private or public decision making.

But extensive use of mathematics has some serious defects. On the one hand they can only be used for short-term equilibrium situations. They cannot be useful in showing long-run changing tendencies of the economy. As Myrdal points out, there is no mathematics that can be applied to the disequilibrium of the dynamic evolving economic process (2). On the other hand, mathematical and econometric techniques are useful if the data can be quantified. However, major aspects of economic systems do not lend themselves to be quantified. For example, technical change, effects of cultural and institutional milieu, conflicts among the power groups, etc., cannot be measured. These kinds of variables are taken as given in standard econometric models. However, in neoinstitutional economics the major focus of interest is centered on these nonquantifiable effects.

The tendency in conventional economics is to "technicalize" the science of economics. In other words, to treat the data on economic facts in a way similar to what is done in the physical sciences. But it neglects a very important feature of the economic process. Economics is a part of the overall social sciences. Physical data are not changed by time, but this is not true for economics. Economic data are related to the behavior of humans in satisfying their economic needs and is subject to change. It is not possible to reduce the logic of

62) Gunnar Myrdal, Beyond the Welfare state, economic Planning and Its Implications, New Haven: Yale University Press, 1960, p. 215.

industrialization to rigid mathematical or economical formulations. Therefore, economic methodology should not only be confined to the mechanistic techniques but also to go beyond these techniques and investigate the institutional structure in order to get a better understanding of the economic progress (3).

Neoinstitutional Economics

The Great Depression pushed the Keynesian revolution to the forefront of economics. However, as conditions changed it became evident that the accepted neoclassical version of the Keynes theory was ill-suited for the pressing problems in the domestic and international scene. The failure is probably not in Keynes, but in the analytical system created by those who tried to elaborate his ideas. After the Second World War, the neoclassical synthesis with the more extensive use of mathematical and econometrical techniques brought economic theory farther and farther away from economic reality. (4)

The dissatisfaction with the neoclassical paradigm switched the focus of attention to the neoinstitutional economics over time. In this part we will review the main ideas of neoinstitutionalists. Although each author has his own version of institutional explanations, the differences seem to be in the details rather than in the fundamental ideas.

Neoinstitutionalists argue that the economic process cannot be understood in isolation from its cultural and institutional environment. We cannot neglect history and time in economic process. According to them, social sciences are altogether concerned with the analysis of the functioning of the total social

(3) G. Edward Schuh, "Agricultural and Applied Economics: Challenges of the 1980's." The University of Minnesota, Department of Agricultural and Applied Economics, August 1980, p.34. (Mimeo)

(4) Wallace C. Peterson, "Institutionalism, Keynes and the Real World," Journal of Economic Issues, Vol. XI, No. 2, (June 1977), p. 202.

system. The social system is an evolving pattern. It covers a complex of human relations or the ways in which man meets his numerous needs. This broad system may be broken down into a number of subsystems. Each one of these deals with a special kind of human needs. Economics is one of these subsystems and the major interest of this area is to meet the material needs of human beings.

A major characteristic of these subsystems is that although each one is concerned with a certain part of social system, they are not unrelated. For example, economic facts generally appear to have social, political and historical dimensions. Depending on this idea, Gunnar Myrdal proposes to relate the analysis of the economic system to the overall social system of which economics is a part. This will give the economist a more comprehensive idea about the nature of the economic process. This kind of treatment makes Myrdal's economics some kind of "Social economics."

As was pointed out before, neoclassical economists patterned their economics after the physical sciences. Whereas neoinstitutionalists insist adamantly to keep economics as a "social science" and to distinguish it from physical sciences at all times.(5).

Man is the central concern in neoinstitutional economics. But just as it excludes physical phenomena, the behavior of an isolated man is not of importance. There are no social relations or social problems in Robinson Crusoe's world. One cannot learn much by inquiring into the behavior of the isolated individual. Therefore, man living in a social or cultural environment is the subject of neoinstitutional economics.

In the following we will compare it with the neoclassical economics:

1. Economic system as an ongoing process

According to neoinstitutionalists the economic system is not a mechanistic system tending towards

(5) Gruchy, p. 291.

a state of balance or equilibrium. On the contrary, it is cultural and evolutionary. Therefore, disequilibrium rather than equilibrium characterizes this system.

Individual behavior, economic actions and social behavior are all interrelated and move together. Economic behavior cannot be isolated from the social and cultural environment in which it takes place. As Myrdal points out there are no economic, social or psychological problems but just problems. They are all inter-mixed.⁽⁶⁾ Therefore, in the research process, the job of economists is to analyze the problems from all relevant aspects. This requires a broader, interdisciplinary approach rather than confining it to the narrow boundaries of a discipline.

Technical change is the major force to explain dynamism in a society. Change occurs according to a principle which Myrdal called "cumulative causation." It means that once some forces set a change in motion it proceeds in a cumulative way in one direction or the other. In other words change in one condition will lead to change in others and these secondary changes will in their turn, cause new changes all around in further rounds. For example, constructing transportation facilities in a traditional society may extend the size of markets, which in turn may induce technical change and increase production. Still, an increase in production may cause better nourishment of laborers, better education, etc. In sum, all these factors, reinforcing one another in their effects, will lead to changing the traditional society into a modern economy.

2. Institutionalism and human behavior

Neoclassical economics depends on the assumption of rationality about individual behavior. The notion of "homo-economicus" (individual self-interest) is the major driving force in human behavior. Whereas in the institutionalist model the behavior of individuals is largely determined by the social and cultural milieu, in other words, by the institutional structure.

(6) Gunnar Myrdal, "Institutional Economics." Journal of Economic Issues, Vol. XII, No. 4 (December 1978), p. 774.

Of course it does not mean that human behavior is not rational at all, but it provides an important challenge to the neoclassical rationality principle.

Furthermore, according to neoinstitutionalists, uncertainty, rather than certainty, is the major feature of human behavior. Knowing that man is under the impact of institutions does not mean that we can exactly predict how man will behave in a particular situation. In fact, institutions determine a spectrum of acceptable alternatives from which individuals can choose. But they do not predetermine exact behavior. (7).

3. Conflicts in economic life

Neoclassical economics presents us with a harmonious world. In such a world markets work effectively and silently and the economy moves to an optimum in regard to resource allocation and income distribution. In the neoinstitutionalist model, conflict rather than harmony is the dominant force of economic and social order. There is always coercion, aggression, and struggle for power among the different interest groups in an economy.

It might be an oversimplification to try to explain the whole economic process as a "power struggle" as did Marxists, but it is not realistic to ignore the struggle over income distribution. (8) Harmony in the neoclassical model may mean either that economic agents have no power at all, or possess the power equally. Neither of these assumptions fits the real world. In the real economic system organized interest groups like big business corporations, labor unions or farmers organizations try their best to increase their group benefits in commensurate with their power relations.

(7) William M. Dugger, "Methodological Differences Between Institutional and Neoclassical Economics," Journal of Economic Issues, Vol. XIII, No. 4 (December 1979), p. 905.

(8) John E. Elliot, "Institutionalism as an Approach to Political Economy," Journal of Economic Issues, Vol. XII, No. 1 (March 1978), p. 103.

4. The role of state and the use of power

Coercion and the use of power by various interest groups invite the incursion of government in the scene. The ultimate aim of pressure groups is to capture the state power and use it in their favor. In the face of these endeavors by various groups government has a major role to play. How can it balance these mostly conflicting interests, if at all? Neoclassical economists either ignore the role of state or assume it to be neutral. However, many neoinstitutionalist economists regard the role of state as protecting the interests of the most dominant groups in the society, like big industrial organizations, trade unions or farmers' associations.

5. Struggle over income distribution

All economic agents, mostly through organizations, are in a continuous struggle to increase their shares of income. Probably power, coercion and conflict is not so obvious in any other branch of economics than in income distribution. Neoclassical economics draws such an unrealistic picture of the world in which each factor receives its marginal product and there is no conflict and use of power. In many cases, it appears that all incomes are not payments to the factors participated in the production, but instead are payments derived from the rest of the society by means of power and coercion. For example, this kind of income flow may simply be a result of restricting the supply and creating artificial scarcities by pressure groups.

6. The role of money

In the neoclassical model, money does not play an active role. Generally, it is accepted not more than as a convenience, a means of exchange. Instead, neoinstitutionalists appreciated the magic role of money from the very beginning. According to them, money is the symbol of wealth, prestige and power (9). It can be derived from productive activities of man or simply by the exercise of power.

(9) Peterson, p. 210.

Hence depending on this basic idea, the "old" institutionalists and neoinstitutionalists divided human activities into two branches; i.e., making of goods and making of money. The former may be identified as productive activity and the latter as pecuniary.

7. The role of mathematical and econometrical techniques

As was discussed above, neoinstitutionalist do not reject the usefulness of these techniques. But, they argue that mathematics can only be used for short-term analysis or if the tendency in the economy is towards the equilibrium. There is no mathematical or econometrical techniques to quantify the effects of cultural or institutional factors in an evolving social system which may be characterized by disequilibrium.

In the above, we tried to point out some major contradictions between the mainstream economics and neoinstitutionalist models. At the present time economists identify themselves with one of these two lines of thought. The defects of neoclassical economics spurred several critics against this system. Gunnar Myrdal expresses his dissatisfaction as follows: "I believe that much of present establishment economics, and in particular, its very abstract theoretical constructs, ... will be left by the wayside as irrelevant and uninteresting" (10).

The Old and Neoinstitutionalism

The present day neoinstitutionalists like Galbraith, Myrdal, Lowe and others, although belong to the same tradition originated by Thorstein Veblen, greatly differ from the so-called "old" institutionalists. None of them, probably with the exception of Ayres was much affected by Veblen. Therefore, the present day institutionalists are called as "neoinstitutionalists" to distinguish them old institutionalism of Thorstein Veblen.

The major difference may be seen in their attitudes towards conventional economics. Veblen attacks strongly...

(10) Myrdal, "Institutional ...," p. 780.

on the equilibrium economics and in the final analysis seems to dispense with the whole inherited standard economics. Veblen was an unsophisticated technocrat. There would be no market system and price mechanism in his technocratic regime of workmanship in the future. (11). In this regard, the neoinstitutionalists take an opposite view. They do not reject the use of conventional economics but accept it for its own worth. They find it too narrow, so they want to go beyond it and develop a broader economics which is concerned not only with decision making in the market place but also with the guidance of the larger evolving economic system. (12).

Veblen was criticized being under much influence of Marx. He regarded the economic system as a continuous struggle between two classes, i.e., "vested interests" and workers as Marx did. According to him the former of these classes always exploited the latter and the role of state was not more than to protect the interests of big business. He analyzed the American economy in terms of a progressively declining national income and predicted an eventual bankruptcy of the capitalist system. The development of Veblen's ideas was probably much influenced by the economic environment of his time. In his lifetime he witnessed an enormous growth of business and the inefficient role of government in the control of these corporations.

He was also criticized by accepting an untenable technological determinism. He seemed to overemphasize the role of machine process to determine human behavior. Neoinstitutionalists regard technology as an important factor for the evolution of total economic system but they do not accept its role to shape mental attitudes or to condition human behavior to a degree envisaged by Veblen.

(11) Grunsky, p. 16.

(12) Pham Chung, "Clarence E. Ayres and the Socialist Planning Debate," Journal of Economic Issues, Vol. XII, No 1 (March 1978), p. 71.

Institutional Change

If economic system is an evolving system then it has to be the task of economists, social scientists or philosophers to explain the course of this change. There are many attempts in this field, some of them are new, others have a long history. But none of them seems satisfactory.

Before getting further it might be useful to make a definition of institutions. Ruttan defines institutions as "the set of behavioral rules that govern a particular pattern of action and relationships," (13). The concept of institution also includes organizations like a family a firm or a government administration, etc. Because organizations as decision making units are influenced by externally given behavioral rules, which are products of tradition or decisions by another organizations. Thus, the term institutional change may mean changes in behavioral rules, performance of organizations or relationships between an organization and its environment.

1. The orthodox views

As would be expected, theoretical analysis of economic institutions was not a major issue for neo-classical economists. Nonetheless, classical economists like Smith, List and Mill referred to the institutional structure of society in their writings. It is true that they did not make significant contributions in this area, but nevertheless, their ideas may provide a starting point. (14).

Adam Smith attributed economic progress to individual acquisitiveness of man. According to him, the acquisitive nature of man is the driving force in a society.

(13) Vernon W. Ruttan, "Induced Institutional Change," in Induced Innovation: Technology, Institutions and Development, edited by Hans P. Binswanger, et al., Baltimore: Johns Hopkins, 1978, p. 329

(14) Daniel R. Fusfeld, "The Development of Economic Institutions," Journal of Economic Issues, Vol. XI, No. 4 (December 1977), pp. 745-750

By expanding markets and generating capital accumulation it leads to transformation of an agricultural economy into a diversified economy of agriculture, commerce and manufacturing. List followed the suit. But according to him community action, besides individual acquisitiveness plays a positive role for the development of non-economic institutions. Similarly Mill argued that progress in production is subject to immutable laws, but patterns of income distribution is man-made. Nevertheless, he did not attempt to analyze the institutional arrangements that affect patterns of income distribution.

In contrast to above mentioned economists, David Ricardo did not interest in institutions at all, and his ideas came to dominate the classical school.

In fact, Ricardo missed an important opportunity to develop a comprehensive theory of institutional change as a by-product of his work. He argued that capital accumulation under the conditions of diminishing returns would lead to a stationary state. But he assumed it to occur in a given institutional context. He used capital accumulation as the driving force in his model but did not succeed to analyze the technical change and monopoly powers associated with it. This line of reasoning was to be taken up later by Marx and neoinstitutional economists.

The universal acceptance of general equilibrium models almost closed the door for the analysis of institutional change. However, a few attempts were made in neoclassical framework. One is that of Joseph Schumpeter. He argued that innovations by entrepreneurs to obtain profit disturb the equilibrium situation. The new techniques or innovations will expand throughout the economy and finally a new equilibrium will be established. According to Schumpeter, innovations even as indicators of the success of capitalism will eventually lead to demise of capitalist system by creating fluctuations, big business and turmoil.

Another attempt to analyze the institutional change within neoclassical framework was made by Douglas North in collaboration with Lance E. Davis(15).

(15) Institutional Change and American Economic Growth, Cambridge: The University Press, 1971,

He starts with a case in which Pareto optimality prevails and assumes an exogenous change which makes it possible to obtain profits by changing institutions. Then economic agents will be induced to change the existing institutional framework to internalize the potential gains. At this point, there are two alternatives. According to one, a group gains without making anybody worse off. This corresponds to a Pareto superior solution. According to the other, a group gains, but at the expense of others. This refers to a Pareto inferior solution (16). The second case implies the use of coercion and probably government support for the new income distribution.

North-Davis model is neoclassical in the sense that while the existing equilibrium is broken, self-regulating forces will be set in motion to establish a new equilibrium.

2. The institutionalist view

It has been a major concern for institutionalist economists to explain the evolving nature of social systems. In their models, they emphasize the relations between technological change and institutional change as dynamic forces in the social and economic system.

Before going through their analysis we will review the Marxist views on institutional change. In fact, Marxist theory of institutional change influenced the ideas of many neo-Marxists or non-Marxists in our time.

Marx explains that man has a constant striving to produce material things. It comes from the nature of humans and leads to a continuing improvement in the forces of production which brings about abundance. However, scarcity leads to a struggle for the control of resources. In consequence, there is always conflict between those who control the economic resources and those who do not. In the Marxist terminology, the struggle is between the classes of capitalists and workers. Marx believes that the centralization of capital and the

(16) Rusfeld, p. 748.

resulting exploitation of masses of labor finally will lead to the demise of the capitalist system.

In the Marxist model there is a major contradiction between institutions and changes in production technology and production relations together form the basis or "infrastructure" of a society. Instead, social, political or economic institutions set up the "ultrastructure" of an economy. Marx stresses the dialectical relationships between economic base and ultrastructure. But he believes that the effect of a change in the base is more influential in changing the institutional structure, rather than vice versa. Thus, any change in technology will generate conflicting effects with the present institutions and finally will lead to substitution of these with new institutions. (17).

The view that institutional change depends on technological change is called "technological determinism". This idea basically originates from Karl Marx. As was stated before, Veblen following the same line of thought, argued that advances in technology would lead to concentration of capital in big business and thus, create change in the institutional framework.

In contrast to the technological determinism there is another approximation to the institutional change which is called as "institutional determinism." It argues to the contrary of the Marxist version of Technical change, i.e., technical change depends on institutional change, rather than vice versa. This is the main thesis of Polanyi's argument. (18).

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- (17) J. Ron Stanfield, "Limited Capitalism, Institutionalism and Marxism," Journal of Economic Issues, Vol. XI, No. 1 (March 1977), pp. 61 - 71.
See also: Douglas E. Booth, "Collective Action, Marx's Class Theory, and the Union Movement," Journal of Economic Issues, Vol. XII, No. 1 (March 1978), pp. 163 - 185.
- (18) Karl Polanyi, The Great Transformation, Boston: Beacon Press, 1957, pp. 112 - 125.

Another form of institutional determinism is discussed by Chandler. (19). He argues that expanded market opportunities led to revolution in management techniques which in turn created an environment conducive to technical change.

The North-Thomas Views

Apart from his initial essay to which we referred above, North has another attempt in collaboration with Robert P. Thomas (20). In his second study he follows a different approach. His discussions are in the line with institutional determinism.

North and Thomas explain the sources of Western economic development in terms of increasing population pressure against the fixed land resources. They accept the population increase in the Middle Ages as the driving force in the dynamic change of the European development. They argue that the population increase brought further land into cultivation and forced people more out towards the inner parts of Europe to settle down. As this process continued, production increased and became more diversified in response to different qualities of land. These differences in production stimulated trade and specialization and led to development of organized markets. The expansion of market in turn induced technical change, urbanization and a set of other social changes like transformation from the feudal system to national states.

North and Thomas argue that any change in relative factor prices (as a result of a change in relative factor endowment) leads to a redefinition of property rights which in turn brings about an associating modification in institutional structure. For example, in their study they showed that the scarcity of land as a result of the increasing population, between the 10th and 13th centuries, led to a more precise definition of property

(19) Alfred D. Chandler, Jr., Strategy and Structure, Cambridge, Mass.: M.I.T. Press, 1972, p. 277.

(20) Douglas C. North and Robert Paul Thomas, The Rise of the Western World: A New Economic History, Cambridge, Mass., The University Press, 1973.

rights with respect to land. Thereby it created a pressure to limit common property uses and adopt more intensive farming systems.

By the same analogy, as land became less stringent in agricultural production in the U.S. in our times, property rights changed in a way that private rights have been reduced on land. Conversely, since population increase is the major factor in most developing countries, the scarcity of land requires a more elaborate definition of property rights with regard to land resources.

We may refer the same idea to the common goods like environment. At the present time the demand for environmental services has increased and led to the rise of the value of these services. Hence, it creates a need for new institutions designed to clarify property rights of individuals, firms and communities with respect to these increasingly common property resources which used to be free previously (21).

Despite its merits the North-Thomas model in essence depends on self-regulating forces in the economy. Once population increase disturbs the present equilibrium, it will put self-regulating forces into motion which will eventually restore equilibrium. This is not a quite dynamic change model. Secondly, one of the basic features of social systems, is conflicts between the interests of different groups. But it has no place in this model. Thus, North-Thomas model seems to offer us a harmonious world as the neoclassical economics would do.

The Ruttan Model

Ruttan adopts a similar approach for institutional change as he used for induced technological change. He explains that institutional change is induced by the demand for more effective institutional performance and it occurs as a result of advances in the supply of knowledge about social sciences.

According to Ruttan model, changes in relative factor prices (associated with relative factor endowment) is a source of demand for institutional change.

(21) Ruttan, p.335

As will be understood, this is not so different from the basic idea of North-Thomas model. For example, an increase in wages in relation to capital (e.g., as a result of scarcity of labor force) will induce technical changes to substitute capital for labor and lead to a redefinition of property rights of the worker over the conditions of his employment.

In a similar approach, Theodore W. Schultz attributed the demand of institutional change to the rising value of man during the process of economic development (22).

Another source of demand for institutional innovation is the new income streams originating from the efficiency gains following technical change or improved institutional performance. In the neoclassical world the new income streams would go to owners of production factors with inelastic supply. Whereas according to Ruttan, technical innovations induce attempts on the part of the owners of factors, social classes and economic sectors to create new institutions to partition the new income streams. These groups may endeavor this goal, for example, by collective action or modification of property rights.

Again he finds a close similarity between the supply of technical change and the supply of institutional change. Supply curve for technical change shifts to the right in response to advances in knowledge about science and technology. In a comparable way, advances in knowledge about social sciences will shift the supply curve of institutional change to the right. Progress of knowledge about the social sciences reduce the cost of institutional change. Therefore he points out the importance of research activities in the social sciences for the purpose of increasing efficiency.

According to Ruttan, the question of precedence between technical and institutional changes is of no use; these two factors are highly interrelated and should be analyzed within this context.

(22) Theodore W. Schultz, "Institutions and the Rising Economic Value of man," American Journal of Agricultural Economics, vol. 5 (December 1968), pp. 1113 - 1122.

The Ruttan model has the advantage of explaining institutional change by means of endogenous factors. It also refers to the conflict of interest between various income groups. However, amidst these conflicting groups he does not show explicitly the role of government. Furthermore, he seems to ignore the importance of the vision of leaders in a society in the way of accelerating or resisting the forces of change. Apart from these all, it requires further investigation on the relations between changes in relative factor prices and institutional change. For example, it could be interesting to inquire into the nature of this responsiveness in different societies and at different times.

Neoinstitutionalism and Development Economics

Most significant impact of neoinstitutionalism has probably been in the field of development economics. In fact, it is a relatively young branch of economics. The history of modern development economics goes back to the early after the Second World War. After the war, with the independence of many formerly colonies, the number of developing countries increased substantially and the development problem has been one of the major issues of international community.

Development means rising per capita incomes associated with changes in institutional framework. In many developing countries, main obstacles to change are institutional, e.g., lack of work discipline, illiteracy, poor health conditions, inefficient government bureaucracy or simply unfavorable traditions and customs, etc. Therefore, development in the first place requires the elimination of these barriers and the introduction of a more dynamic institutional environment conducive to industrialization.

In the literature of economic development the terms of "growth" and "development" are generally used interchangeably. But there is in fact a fundamental difference between the two concepts. Growth refers to the rate of increase in per capita income and output without implying any change in institutional structure or social and cultural value system (23). Conversely, development refers

(23) Philip A. Klein, "An Institutional view of Development Economics," Journal of Economic Studies, Vol. XI, No. 4 (December 1977), pp. 786.

net only to per capita income growth but also to institutional changes that come out in association with the rise of income and output. In other words, growth implies quantitative increases while development refers to qualitative as well as quantitative aspects.

Development is a process rather than an equilibrium situation. The relationship between technical change and institutional change is the most dynamic force in a developing society. The dynamic nature of development economics distinguishes it from the mainstream economics. In fact, the idea of change is vastly different from the neoclassical concept of "dynamic equilibrium". At this point, Klein finds great similarity in the general approaches adopted by the modern development economists no matter how they identify themselves, a neoinstitutionalist or a neoclassical economist. He maintains that every economist dealing with development problems should be an institutionalist because of the nature of the subject.(24).

Since development is a process it should have no finite end. All economies change at all times. According to this point of view, each country has a place on the development path. The difference of development among countries is only in relative terms. In this sense the "industrialized" countries are also developing. Naturally, countries at the lower and higher points of development path would deal with different types of problems.

But for a long time, economists tried to solve the problems of developing countries by means of the principles of mainstream economics which they were accustomed to use, without many qualms about whether they fitted these different conditions (25). In those days growth economics was merely an extension of the Keynesian system and its macroeconomic concepts. In these earlier models physical capital investment was the central point of view. According to the Harrod-Domar model, a country's growth was simply determined by the propensity to save and the capital-output ratio. In these models, to attain the target rate of

(24) Klein, p. 792

(25) Myrdal, "Institutional Economics," p. 781

development, any shortage of domestic resources (a saving gap) or imported goods (a foreign exchange gap) could be made up by the foreign inflow of capital. This line of thinking probably derives its roots from the success of Marshall Aid Program. The American capital contributions to the war-stricken countries of Europe after the Second World War became a major stimulant to their growth.

But conditions in present day undeveloped countries are very different. The European countries no matter how severely were damaged by the war had inherited the Western institutions and social value systems. Whereas in most present day developing countries the institutional structure is an extension of the centuries old feudal system and is very unfavorable for development.

In the late fifties and early sixties there grew a whole literature on sophisticated mathematical planning models. These models were depending on two crucial assumptions. One was the concept of fixed capital-output coefficients, the other was the input-output matrix. According to these models, planners should determine the balanced distribution of investment funds among industries to achieve the target rate of development (26). This kind of analysis suffers from the same defects we pointed out before for conventional neoclassical paradigm. It is a "mechanical" treatment of economic development and makes no reference to the effects of institutional and technical change. The neoclassical techniques can hardly be valid at an economy with an unfavorable institutional environment for development. For example, in project evaluation the idea to maximize present value of future income flows might not be meaningful in the face of the institutional barriers to development.

In development economics, concepts such as capital, saving, consumption, imports, exports, etc., should be analyzed within the institutional framework. For instance it may not be correct to relate the propensity to save only to the level of national income. Instead, it may

(26) Arnold C. Harberger, "An Economist Views the Development Process," paper presented at the NSF Conference University of Minnesota, October 1980, p. 3.

require an inquiry into the organization of capital markets, income distribution in the society or saving habits of the people.

The operation of Gunnar Myrdal's "cumulative causation" principle requires special attention. Once an underdeveloped economy is set in motion in the direction of development, the change will occur in a cumulative way. But here Albert Hirschman's "big push" theory may not be neglected. To give the initial impetus to the economy it may require a great deal of effort.

In the theory of economic development as it is true for general social change, the role of leaders may not be underemphasized. Their vision and leadership capabilities may be an important factor to accelerate, resist or change the direction of underlying forces in a society. Of course, increased knowledge about the development economics will assist them in choosing the best alternatives and thus lead to minimize the costs of institutional change.

In the literature of economic development two major approaches to development are discussed. These are import-substitution and export-promotion strategies of development. They start from differing premises. The former is an inward-looking while the latter is an outward-looking policies of development. In the past most developing countries adopted import substitution policies. More recently as a result of the disillusionment with these policies they started to switch to export-oriented policies. It should be pointed out that development is a subject with many dimension. In making a decision, besides neoclassical concepts, social, cultural and historical conditions must be analyzed very carefully. Here, of course, the "development" of development economics as well as the foresightedness of political leaders reveal itself.

International Aspects of Development Process

According to the mainstream economics, free play of market forces in the international scene lead to mutually beneficial trade between the developed and the developing countries. The industrialized countries altogether form the "center". The development of "periphery" depends on the policies of the center, to a large extent.

As growth keeps on going in the center, the demand increases for the agricultural products and raw materials of the peripheral countries. The extension of their exports in return, with the financial and technical assistance of the center will provide an external stimulus to the development. The underlying idea in this model is that industrialized countries, by acting in compliance with their national interests would also contribute to the development in the periphery. In other words, the development of the latter would depend on the international economic institutions functioning well for the interests of the former.

This idea seemed to prevail in the academic and political environments to the recent times. The functioning and organization of international economic and monetary system depended on the policies of "big" countries, although accounted for more than two-thirds of the total world population, did hardly play any active role in these regulations. The Bretton Woods system, for example, was a compromise between the U.S. and the Great Britain. Accordingly in no part of the charter of the International Monetary Fund a simple reference could be found the special situation of the developing countries. Similarly, GATT was initiated by the developed countries to lower tariffs on industrial goods and restore conditions for a relatively free international trade. Likewise, the world monetary and trade rearrangements in the 1960's were made mostly through the decisions of the "Group of Ten", i.e., representatives of the big ten, industrialized countries.

But as time went on the need for change in the international order became more pressing. Underdeveloped countries came to criticize severely the existing system and argued for a new international economic order. The developing countries formed various regional or global groupings to express their ideas for a change in international institutional order. One of the most important organizations established by them is UNCTAD which serves as a stand where policies of developing countries about various world issues is formulated, coordinated and expressed. Another comprehensive movement among the developing countries is the forming of the "Group of 77" which includes all independent, non-aligned Third World countries. Today discussion for a New International Economic Order is being carried on in the framework of the North/South dialogue.

The dissention with the existing international institutions originates from the facts of the world community as well as from the studies in the academic circles. In spite of the automatic growth hypothesis of the mainstream economics, the per capita income differences between the developed and the developing countries have been greater than ever. Hunger and misery have become the prevailing facts of the masses in many developing countries.

Over time, the conventional idea that international trade represents a harmony between the interests of different countries came under attack by academicians and political economists. In the late 1940's, Ra'ul Prebisch from Latin America and German Hans Singer formulated a hypothesis which later came to be known as "Singer-Prebisch thesis". According to this argument, the long-run trend of the terms of trade between the agricultural and manufactured goods is in favor of the latter and against the former. In other words, the developing countries that export agricultural products and import manufacturing goods suffer from the secular deterioration in the terms of trade. This implies that through international trade mechanism, some part or all of the incomes accruing from growth in the developing countries is transferred to the industrialized countries (27).

The tendency of secular deterioration in the terms of trade is explained by the slow increase of demand for agricultural products as compared to manufacturing goods (the Engle's Law), powerful monopolies and labor unions in industrialized countries and low flexibility in the structure of developing economies.

Arthur Lewis, instead explained the same phenomena with reference to "unlimited supplies of labor" in the subsistence sector. He argued that since real wage levels

(27) More recently Bhagwati showed theoretically that, because of the deterioration in the terms of trade a country may be worse off after the growth, a situation which he calls "immiserizing growth". See: Jagdish N. Bhagwati, "Immiserizing Growth: A Geometrical Note", The Review of Economic Studies, Vol. XXV, No. 68. (June 1958).

in developing countries are depressed because of the unlimited supplies of labor, any gains from the productivity increases in the export sector would go to the industrial importing countries.

Another attack on the play of market forces in international economy comes from the work of the well-known Swedish economist, Gunnar Myrdal, to whom we referred before in various connections. He applied his principle of "cumulative causation" to the world economy to understand the reason of increasing and persistent income disparities among the nations. He explained that when rich industrialized nations trade freely with poor non-industrialized countries, the poor are pushed into a downward cumulative process that leads to a lower standard of living. This result is brought out by a mechanism that Myrdal describes as the "backwash" effects (which was later called as "polarization" effects by Albert Hirschman) of international trade.

Backwash effects are the secondary consequences of trade between rich and poor nations which cause the economy in the poor country to decline. When an industrial country exports manufactured goods to an underdeveloped country which has no customs duties or quotas, then the smallscale, young industries in the latter will be damaged and finally will disappear. This initiates a circular cumulative process of causation. As the small-scale industry of the poor country declines, industrial external diseconomies develop. Skilled workers lose their jobs, credit system is weakened, people start to return to agriculture and urban culture suffers. These factors push the country further down the path of development (28).

In the meanwhile, this mechanism works in the opposite direction in the industrial country. It enjoys favorable "spread effects" (called as "trickling down" effects by Hirschman). It provides impetus for further industrialization and progress in the industrial country. However, the spread effects are generally assumed less important than backwash effects.

(28) Gruchy, pp. 201-206.

Myrdal proposes national economic planning and protectionist policies to the developing countries in order to evade the distortion effects of international trade and start off a cumulative process of economic development.

In sum, these studies show that in contrast to what the mainstream economics show, free play of market forces in an unregulated international economy, cause the poor to be poorer and the rich to be richer. The present day unequal income distribution coupled with the results of these studies make it indispensable to establish a new international economic order which depends on just and equitable relations among nations and serves the interests of developed and developing countries more satisfactorily. In fact, the establishment of such an institutional order can only be possible by means of cooperation of the industrialized countries. Today this cooperation seems much more compulsory in the face of the pressing problems like world energy crises, breakdown of the international monetary system, worldwide inflation and unemployment (29).

The Theory of International Economics

At the present time theory of International Economics is a special case of Walrasian general equilibrium. The assumptions of international trade is not realistic. It assumes that each nation has free competitive market there is a harmony among nations; in other words, there is no coercion and exercise of power in the international arena. Furthermore, it assumes that the whole world economy is assumed to be in equilibrium or moving to an equilibrium.

As will be understood, the same assumptions are made in the general mainstream economics. So the theory of International Trade may be criticized on the same grounds. In fact, from the standpoint of individual countries, disequilibrium rather than equilibrium is the major characteristic of foreign trade. It is hard to find a country which can maintain an equilibrium in its foreign economic relations, among the whole developed and developing countries of the world.

(29) Schuh, p. 31.

From a global point of view, the net result of total international economic relations is supposed to be in balance. But this does not mean that it is in equilibrium. As factors like production technology, transportation and communication facilities, tastes of consumers, factor endowment change, the volume, composition and direction of trade will also be changed.

The international institutional structure has a direct implication for the change of trade. In this connection one can point out the importance of international payments system, banking institutions and legal arrangements.

Similarly, it is not true that perfect competition prevails in both the commodity and factor markets of the developed and developing countries. In fact, big business companies as well as powerful labor unions dominate in the international commodity and capital markets. Conflict rather than harmony appears to be the outstanding feature of international trade. On the one hand, governments with the pressure of domestic producers On the one hand, governments with the pressure of domestic producers or for reasons of economic development impose high protective measures and deny the free entrance of foreign goods into their domestic markets. On the other hand, by using their monopoly power, big industrial companies may charge high prices to exploit foreign consumers. In fact, monopolies in export sector are very common in all countries and generally governments encourage the setting up of monopolies in export industries. Even in some cases, to gain a complete monopoly position in world markets, government takes over the exporting activities of private export corporations.

Multinational firms are the most prominent feature of today's world production and trade. Multinationalization of big business is quite a new phenomenon. It started after the Second World War, and proliferated progressively. These giant companies transgress the national boundaries and carry out their production processes, throughout the world. Their economic power is comparable not only with the national incomes of many individual underdeveloped countries, but also with those of some industrialized countries. They can easily control production techniques, share world markets

or impose arbitrary prices. More often than not, conflicts arise between the multinationals and the national governments of the countries in which they operate. As a consequence of their huge economic power, they can exert a considerable political influence. Therefore, in the case of a conflict with the national governments, they are in a very powerful situation to solve the disagreement in their favor. At the present time there is not an agreed code of conduct in international community to regulate the operations of multinationals.

In sum, it seems necessary that the theory of International Trade should be modified in such a way that there is no equilibrium in world economy, perfect competition does not prevail in participating countries, multinational corporations are one of the most important agents of world economy, coercion and struggle of harmony prevails in the international scene.

Conclusion

In this paper we tried to explore the main ideas of neoinstitutional economics, indicate its distinctive features from the conventional neoclassical economics and reevaluate the neoclassical techniques of economic development.

We indicated that neoinstitutional economists regard the economic system as a part of evolving general social system. They don't reject the use of neoclassical techniques but instead criticize it for having narrowed the scope of economics. In fact, they argue that economic system does not only consist of price mechanism and market relationships. Their ultimate aim is to go beyond the market forces and inquire into the nature of non-market aspects.

Neoinstitutionalists believe that disequilibrium rather than equilibrium characterizes the real economic system. According to them, instead of harmony, conflict, coercion and exercise of power are the main features of this system.

They accept the change of technology and the institutional change as the most dynamic elements in a society. However, with respect to the process of institutional change not a well-defined, comprehensive theory has been yet formulated.

Despite its merits, institutional economics does not seem to be influential in the various branches of economics, except the development economics. Most recently, economists working in the development field, no matter identify themselves with neoinstitutionalism or mainstream economics seem to adopt a similar neoinstitutionalist approach.

The technical revolution, tremendous growth and proliferation of big business, and the emergence of many developing countries after the Second World War, created such broad and complicated problems that for the solution of which the mainstream economics does not seem to provide reliable techniques. This fact may provide an impetus for mainstream economists to broaden their approach and seek for causes outside the customary confines of economic research. With respect to the future of the neoinstitutionalism, Myrdal states as follows: (30) "I believe that in the near future, it is destined to win ground at the expense of conventional economics, and not primarily because of the strength of its logic (but also) because a broader approach will be needed for dealing in an effective way with the practical and political problems that are now towering above and threatening to overwhelm us."

Nevertheless, at the present time, neoinstitutionalism does not seem to be a unified body of economic thought like the neoclassical paradigm. Its ultimate aim is to broaden the scope of economics. But its boundaries are not well defined. This vagueness probably reflects its wide ranging interest. Neoinstitutionalism reject a narrowly defined, mechanistic view of the economic system.

Furthermore, when non-market institutions are accepted as a part of the economic fact, it is not known what kind of techniques to be used to account for the effects of these institutions.

(30) Myrdal, "Institutional Economic," pp. 779-780.

In this connection Roumasset's efforts should particularly be noted (31). He attempts to analyze the institutions with respect to "first-best" and "Second-best" solutions which may compare with the similar concepts in neoclassical economics. His analysis may prove useful for being capable to be tested empirically. However, much more efforts should be made to develop new approaches for the analysis of a truly dynamic evolving economic system.

(31) James A. Roumasset, "The New Institutional Economics and Agricultural Organization," The Philippine Economic Journal, Number Thirty Seven, Vol. XVII, No. 3., 1978, pp. 331-348. And also the same authors: "Sharecropping, Production Externalities and the Theory of Contracts," American Journal of Agricultural Economics, November 1979 pp. 640 - 647.

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NEO-KLÂSİK TEORİ VE EKONOMİK KALKINMA

(Özet)

Neo-klâsik Teori, kullandığı matematik ve ekonometrik tekniklerdeki gelişmelere rağmen, günümüzün önemli ekonomik sorunlarına yeterli çözümler getirememiştir. Neo-Klâsik teorideki bu yetersizliğin bir nedeni, kuşkusuz karşılaşılan sorunların daha geniş kapsamlı ve komplike oluşudur. Fakat diğer bir neden de, iktisadi hayattaki gerçek değişmelerin aksine, teorinin çok dar bir alanda ilerlemesidir. Bu da, iktisatı sosyal ortamdan soyutlatıp, daha ileri matematik teknikler kullanarak ana "mekanik" bir bilim niteliği verme çabalarından kaynaklanmaktadır.

Bir ekonomik sistem yalnızca piyasa ve fiyat ilişkilerinden ibaret değildir. Ekonomik olaylar belirli sosyal, kültürel, tarihi ve kuramsal özellikler taşıyan ortamlarda oluşur. Ekonomik karar alma sürecinde bu piyasa-dışı kurumların etkisi ihmal edilemez. Fakat maalesef, çoğu kez bu gibi faktörlerin etkisini matematik olarak ölçmek de mümkün olmamaktadır.

Daha başlangıçta hatırdan tutulması gereken nokta, iktisat'ın bir sosyal bilim olması ve sosyal bilimlerin diğer dalları gibi zamanla değişmeye tabi oluşudur. Toplumsal değişim ve dinamizm onu "fizik" bilimlerden ayıran önemli bir farklılıktır. Oysa İkinci Dünya Savaşı'ndan sonra Neo-Klâsik ekonomistler, iktisadi matematik modellerin dar kalıpları arasına sıkıştırmak çabaları yanında, toplumsal kurumlardaki değişim sürecine de yeterli bir açıklama getirememişlerdir.

Diğer yandan, Neo-Klâsik teori üretici ve tüketiciler arasında uyumlu, durgun ve çelişkisiz bir dünyayı öngörür. Oysa gerçek hayatta ekonomik birimler veya gruplar arasında "uyum"dan ziyade, çıkar çatışmaları, baskı ve zorlamaya dayanan ilişkiler yer almaktadır. Böyle bir ortamda gelir dağılımı çoğu kez faktörlerin ekonomik verimliliğine bağlı olmaksızın sahip olunan "baskı gücü"ne göre değişmektedir.

Bu çalışmada, "Yeni-Kurumsal Ekonomi" diye bilinen ve Neo-Klâsik Ekonominin eksiklerini tamamlayabilecek özelliklere sahip olan akımın temel görüşleri açıklanmış ve az gelişmiş ülkelerin kalkınması açısından bir değerlendirilmesi yapılmıştır.