Economic Systems 37 (2013) 345–353

Contents lists available at SciVerse ScienceDirect

Economic Systems

journal homepage: www.elsevier.com/locate/ecosys

Institutions, social capability, and economic growth

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ARTICLE INFO

Article history:
Received 24 October 2012
Accepted 19 December 2012

JEL classification:
O40
P50
N90

Keywords:
Social capability
Institutions
Economic growth
Comparative development
Economy of China

ABSTRACT

I discuss correlations between the historical growth of social capabilities and patterns of economic growth across world regions since the industrial revolution and especially in recent decades. Based on this analysis, I argue that the apparent relationship between institutions and economic growth results in part because better institutional performance goes hand in hand with more advanced social capabilities.

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1. Introduction

As an undergraduate, I took a course on the history of economic thought and learned from it that there had once been an important school of thought, based particularly in the United States, known as institutional economics. Little about this was mentioned during my graduate studies, so it was not until I taught a course on the history of economic thought as a young professor that I read more on the topic and learned that in the late 19th and early 20th centuries, institutional approaches had enjoyed at least as many adherents as did the subsequently mainstream neoclassical school in the US. Something similar was true of Europe, where institutionalism had a cousin of sorts in the historical school. Being a specialist in comparative economic systems, I was trained to compare capitalist with

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http://dx.doi.org/10.1016/j.ecosys.2012.12.002

socialist economies, so institutions and formal economic arrangements were never far from my attention. But in the 1970s and 1980s, the concept of institutions seemed to have little place in the economics discipline outside of the comparative systems field and the specialized literature of "new institutional economics".

This inattention to institutions by mainstream economists began to change with the collapse of Communism in Eastern Europe and the Soviet Union at the end of the 1980s. When rapid privatization failed to lead to the quick emergence of vibrant market economies in some ex-Communist countries, economists turned to both economic institutions and aspects of economic culture, such as corruption and social capital, to explain what was going wrong. Privatizing firms and freeing prices were not sufficient to create a well-functioning market economy, one began to hear; rule of law, tax compliance, resistance to corruption, and trust were also required (see, for example, Murrell, 1995).

By the early 2000s, economic institutions had emerged as a major contender for explaining the differences in economic achievement and growth among the world's countries. A debate about whether institutions, geography, or something else determines long-term economic growth has been waged since the late 1990s by economists such as Jeffrey Sachs, William Easterly, Rafael LaPorta, and Daron Acemoglu.

While the existence of such a debate is encouraging, its contents have sometimes been less so. The new institutional economists were reasonably concrete about the institutions they discussed, including private property rights and the M-form corporation. Comparative systems scholars defined economic systems in terms of constellations of institutions; for instance, the (soviet-type) centrally planned economy included as its pillars state ownership of the major means of production, economic coordination by bureaucratic planning and bargaining rather than markets, and a monopoly on power by a Communist party. As another example, Western European social democracy's institutions included private ownership of means of production, markets as the main coordination device, and provision of welfare benefits and services by a democratically-elected government raising revenues via taxation.

In the literature on economic growth, in contrast, institutions are often accorded considerable importance, but they tend to be defined unclearly. Favorite empirical indicators of "institutions" have been security of property from risk of government expropriation, assessments of the quality of government bureaucracy, absence of corruption, and constraints on powers of the executive branch. Most of these are *qualitative* indicators that reflect adherence to norms or aspects of economic culture, rather than structural measures of the presence or absence of specific formal rules, bodies, or mechanisms. The line between institutions and culture is thus unclear. Perhaps that is as it should be, but if so, we also need to recognize the unsustainability of the argument that only institutions matter.

As attention to institutions has shifted from specialist students of economic organization to generalist students of economic growth, there has also been a tendency to lump institutions into coarse categories, epitomized by Acemoglu and Robinson (2012) distinction between "inclusive" and "extractive" institutions. *Why Nations Fail* is perhaps aimed at a general audience, making it unfair to hold it to scholarly standards. But it does appear to be an extension of the scholarly work of Acemoglu et al. (2001, 2002), which introduced the "extractive" institutions category and contrasted it with "institutions of private property". Acemoglu and Robinson group Stalin's Russia, 1990s China, and Mobutu's Zaire under the same "extractive institutions" label, but the first was a quintessential command economy with maximum suppression of markets and decentralized pricing, China of the 1990s lay closer to the state-led capitalism of 1960s South Korea, and Mobutu's was a petty dictatorship monopolizing control over mining and a few other sectors with no effort to eliminate the market economy per se.

Why Nations Fail is also troubling in its insistence on looking for single causes, rather than investigating the degree of influence and the nature of the interactions between the various factors that influence economic growth. In these remarks, I will describe an approach in which geography, social capabilities (a concept that can encompass but is much broader than norms), and institutions (whose operation is much influenced by social capabilities) are interconnected determinants of growth. I'll suggest how that view helps to explain the differences in outcomes among countries and global regions including those in the Americas, in sub-Saharan Africa, and among former Communist countries. Toward the end, I'll provide particular observations about China.

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