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Journal of Comparative Economics 33 (2005) 25–46
Journal of COMPARATIVE ECONOMICS
www.elsevier.com/locate/jce

Market economic systems

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Received 22 March 2004; revised 8 December 2004
Available online 25 January 2005

Pryor, Frederic L.—Market economic systems

The new comparative economics focuses on individual institutions rather than considering the economic system as an entity. In this essay we argue that economic systems should be defined in terms of clusters of complementary or covarying institutions. A cluster analysis of OECD countries, using data on forty different economic institutions, shows that four economic systems can be used to characterize these countries in 1990. These systems had no significant impact on economic growth or inflation, but they did have an important influence on the distribution of income. An analysis of systemic change suggests that, up to 1990, the differences between economic systems became greater with economic development, while the differences between countries with the same economic system became less. *Journal of Comparative Economics* **33** (1) (2005) 25–46. Swarthmore College, Swarthmore, PA 19081, USA.

JEL classification: P-510; P-100; C-400

Keywords: Economic system; Economic institutions; OECD nations; Economic performance

1. Introduction

Research in comparative economics has increased considerably in recent years. The literature on the new comparative economics is reviewed by Djankov et al. (2003) and a variety of related approaches are receiving attention, e.g., Acemoglu and Johnson (2003)

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0147-5967/$ – see front matter
doi:10.1016/j.jce.2004.12.004

and Rodrik (2004). However, these studies deal primarily with individual economic institutions, not with economic systems. In this paper, we use many of the empirical results of the institutional approach to focus on the definition of economic systems and investigate how these systems change over time.

If we start with a common definition that an economic system comprises the totality of institutions and organizations that specify property relations and influence the distribution of goods and services,[1] we encounter an immediate problem. Although theories specifying which institutions appear together to form a system exist, they focus primarily on differences between market and planned economies so that they are not helpful in distinguishing various types of market systems. As a result, researchers are forced to employ ad hoc methods to delineate the various systems of advanced market economies.

One commonly used method involves choosing arbitrarily one or two property or distribution institutions to specify the economic system, e.g., a high degree of government regulation or a high ratio of public expenditures to GDP. Such an approach begs the question of whether the institutions chosen are the most important and whether all other economic institutions and organizations in the economy vary in a similar manner. Another method involves selecting different economies and attaching evocative names to their economic systems, e.g., the US entrepreneurial model, the French statist model, the Swedish socialist model, or the Japanese consensus model. This holistic approach presumes to identify the basic core of the system and does not specify the actual institutional differences among countries in detail. Hence, no real theory of market economic systems exists to explain why particular institutions and organizations cluster together to form a distinct pattern or why certain economic institutions are complements, while others are not. In addition, no theory explains how market economic systems change. In this paper, we address both issues inductively in order to establish the stylized facts that any such theory must explain.

This exercise involves examining the covariance of a large number of economic institutions and organizations using cluster analysis as the major empirical tool. Our method is related to the new institutional economics because it also focuses on quantitative specification of economic institutions and organizations. However, while the new institutional economics has a microeconomic focus and deals with institutions and organizations primarily as phenomena in isolation from each other, we explore these phenomena from a more macroeconomic perspective by considering how specific institutions and organizations within an economy are interrelated and how these patterns change.

The analysis proceeds in four steps. First, we provide a general description of cluster analysis, a technique employed rarely in economics. Second, we apply this analysis to OECD countries using forty different institutional indicators in 1990 and isolate four

[1] The key term is institution and many employ the useful definition proposed by North (1981, pp. 201–202), namely, “a set of rules, compliance, procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals.” In a later paper, North (1998, p. 81) added: “If institutions are the rules of the game, organizations and their entrepreneurs are the players. Organizations are made up of groups of individuals bound together by some common purpose to achieve certain objectives. Organizations include political bodies (e.g., political parties, the Senate, a city council, regulatory bodies), economic bodies (e.g., firms, trade unions, family farms, and cooperatives), social bodies (e.g., churches, clubs, and athletic associations) and educational bodies (e.g., schools, universities, vocational centers).”