

Systematization of Theoretical Foundations of Neo-Institutionalism

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Abstract: The article presents an overview of neo-institutionalism theory. The article reasons the evolution of the classical institutionalism and its transformation into a new theory on the basis of fundamental concepts and discoveries. The subject matter of the article is the analysis of the foundation and stages development of study, as well as present school review and the comparison with the classic institutionalism. The main difference between the two studies is under consideration. The main part of the paper presents the main differences of classical and new institutionalism school. Comparison of neo-institutionalism with neoclassicism which is its ancestor is a particular interest in the article. The article presents the main neo-institutionalism scholars' concepts and works. The authors of the article offer a systematization of scientific knowledge on the basis of this theory, regarding main methodological approaches of this doctrine development. The article presents explanations and comments on the basic neo-institutional theory concepts. The article provides the systematization of the main concepts made on the basis of several factors: the subject matter of institutionalism (basic concepts), basic schools and their representatives, the main theories of institutionalism, approaches for further research in the theory of institutionalism by different schools.

Key words: Neo-institutionalism Theory • Neoclassical Theory • Rational Expectations Theory • Transaction Expenses • Social Institutions • Analysis • Induction • Deduction

INTRODUCTION

Dissatisfaction with traditional economic theory which pays little attention to the analysis and study of the institutional environment of economic subjects functioning led to the emergence of a new school of economics, a new economic approach in science which is known as neo-institutional economic theory last century. This term seems to coincide with the classical institutional theory developed by J. Commons, T. Veblen, and J. Galbraith [1-4]. Despite it the coincidence concerns only old school terminology, for example, the concept of transaction is used in analysis by both J. Commons and neo-institutionalism researchers.

In actual neo-institutionalism research originates from neoclassical economics. This theory uses a number of terms operating with the notion "institutions", which also define its name as *property rights economics* where the

ownership of economic agents is the basis for all economic studies; *transactional economics* that studies the transaction and the implementation expenses; *contract economy* where all market participants are understood as explicit and implicit contracts between them [5].

R. Coase's work "The Nature of the Firm" (1937) laid the foundation of neo-institutionalism research [6]. But until the 1970s it wasn't really investigated and used. Only after the mid seventies it was paid some certain attention to. Since that Neo-institutionalism has been introduced as a new economic thought that is different from the neo-classics and all its neo-orthodox approaches. At first it was developed only in the United States. In 1980 Western and then Eastern Europe began to study it. A new theory has been recognized. R. Coase was awarded the Nobel Prize in economics in 1991 and D. North was awarded the Nobel Prize in economics in 1993 [7, 8].

MATERIALS AND METHODS

Methodological features and studies structure of neo-institutionalism are based on [9]:

- The importance of social institutions in economy.
- The use of standard mechanisms for economic theory analysis.

The Main Part: Overviewing the economics history we can hardly come across these approaches in economic theories. First, we need to define the differences between the classic institutionalism (including modern institutionalism) and neo-institutionalism. There are three fundamental differences [10]:

- classic institutionalism (J. Commons in “Legal Foundations of Capitalism” [11]) took into consideration law and policy trying to study the problems of modern economic theory using methods of other social sciences; neo-institutionalism considers different aspects; neo-institutionalism studies political science and legal problems using neoclassical theory methods and the apparatus of game theory and microeconomics.

- Classic institutionalism is based on inductive method (from the particular to the general) that is why institutional theory has not been developed yet; neo-institutionalism chooses deductive method: general principles of neoclassical theory explain some certain phenomena of social life [12].
- Classic institutionalism being a radical economic thought considered primary activities of groups representing interests of a particular individual (mainly trade unions and government); neo-institutionalism focuses on independent individual who decides willfully and in accordance with his own interests which groups would be more profitable for him (Table 1).

Neo-institutionalism originates and is associated with neoclassicism. During 1950th-1960th neoclassicism representatives suggested that macroeconomic methods and concepts should have a broader sphere than that determined earlier. They began to use the neoclassical apparatus of macroeconomic approaches for investigation of non-market phenomena and processes such as education, public health, marriages, health secure, crime, lobbying, parliamentary elections, etc. Penetration into the social sphere has been called “economic imperialism”

Table 1:

Future	“Old” institutionalism	Neo-institutionalism theory
Foundation	Beginning of XX century – originates from the criticism of orthodox classical liberalism [24].	End of XX century – as a result of improving of the foundations of modern orthodox theory.
Representatives	T. Veblen, W. Mitchell, D. Commons, K. Polanyi, J. Galbraith, G. Myrdal.	R. Coase, J. Buchanan, H. Demsetz, M. Olson, R. Posner, J. Arrow, J. Stigler, H. Becker, D. North, P. Voggel, D. Muller, H. G. Tullock, R. Tollison, J. Hodgesaw, W. Niskanen [25]
Direction	From law and politics to economics.	From economics to law and politics.
Methods	Methods of other Human sciences (law, political science, sociology).	Economic neoclassical theory (methods of microeconomics and game theory) [26].
Focus	Group activities.	Independent individual.
Analysis	Holism – methodological principles of atomism and holism developed simultaneously for a long time, although the term “holism” itself appeared much later [27]. Atomistic approach of reality cognition determined the development of abstract sciences while holistic approach defined the development of the humanities and social sciences [12].	Methodological individualism.
Peculiar features	<ul style="list-style-type: none"> • emerged as an approach of radical economic theory; • studies of the problems of modern economic theory methods of other social sciences (sociology, law, political science); • uses the inductive method (movement from particular cases to generalizations); • pays attention to the actions of groups that represent individual’ interests (trade unions and government); • rejects individualistic approach to society; • demonstrates the limitation of market system; • endogenous research technology. 	<ul style="list-style-type: none"> • conservation of paradigm of neoclassical economics; • consideration of market relations as universal ones; • exogenous research technology.

Table 2:

Subject matter (theoretical concept)	Institutionalism theories	School representatives	Investigation approaches
Institutional environment, the environment where fundamental political, legal, social norms, traditions and rules (constitutional law, civil law, administrative law, election law, contract law, etc.) are formed. These standards occur within the boundaries of the production processes and exchange.	Public Choice Theory [21].	J. Buchanan, G. Tullock, M. Olson	Investigates the rules governing relations in the public sphere. Losses, followed by the activities of political institutions are under consideration.
	Property rights theory [6].	R. Coase, A. Alchian, H. Demsetz	Investigates the rules governing relations in the private sector, aims to explore the welfare of economic agents provided by the legislative institutions.
Organizational forms created by economic agents within the existing general rules and on a contract basis.	Agency relationships theory (agency theory), defines the relationship of the “principal–agent” type [22].	W. Berl, H. Minson	Examines the “principal–agent” relationships.
	Theory of incentive mechanisms (mechanism design)[28, 29].	W. Berl, H. Minson	Investigates organizational schemes of optimal risk distribution of between the agent and the principal.
	Positive “agency theory” [30].	W. Berl, H. Minson	Investigate the “separation of ownership and control” problem.
	Theory, which studies the opportunistic relationships of hired managers.	Y. Merkling, M. Jensen, U. Fama [31]	What steps should be taken to ensure that the behavior of hired managers (agents) are least affected and deviated from the interests of owners (principals)? – is in the centre of attention. In case principals act rationally to consider in advance the danger of opportunist behavior of agents in contracts negotiating, it is necessary to account for the protective measures [17].
Transactional approach to the study of economic organizations.	The theory of transaction costs [6].	R. Coase	Examines the organizations in terms of reducing transaction costs. Unlike agency theory emphasizes of conclusion stage rather than the stage of contracts execution (ex post).
	Theory of costs measurement, the amount and quality of goods and services transferred in the transaction [32].	S. Chen, Y. Barzel, D. Port	Examines the measurement and accounting expenses arising in transactions.
	Theory of “governance structure” problems [23].	O. Williamson	Studies the mechanisms that are used to assess the behavior of participants in the contractual relationship, disputes adaptation to unexpected changes and the application of sanctions against violators. According to O. Williamson, every bargain has its own type of regulatory structure that works best for its performance [9, 20].

(H. Becker) [13]. Economic concepts such as balance, maximization and efficiency became useful for the analysis of other, non-economic phenomena that were not previously responsible for other social sciences. Neo-institutionalism is no exception in the neoclassical theory. On the contrary, it has clearly demonstrated the main manifestations of this approach through penetrating into the sphere of law, organization theory and sociology. This fact had its impact on the mechanism of microeconomic analysis of various social institutions. Besides the impact of these trends on neo-institutionalism, the theory also began to change itself and acquire new economic shape. That was the beginning, birth and development of neo-institutionalism [14].

Neoclassical theory is based on the model of rational choice under conditions with possible limits. Neo-institutionalism uses this model as a base but deprives it of a number of auxiliary functions giving additional new concepts to its content. Here are the main similarities and differences between Neo-institutionalism and neoclassicism. First of all it should be noted that Neo-institutionalism criticizes the traditional neoclassics for its deviation from the basic principle of “methodological individualism”. According to this principle individuals are recognized as the actual functioning agents of social society development [15]. None of collective entities (state or private organization) have an independent existence independent from the totality of their members. All their actions are dependent in terms of purposeful behavior and the actions of individual agents.

According to the “principle of methodological individualism” neo-institutionalism meets a new more profound level of economic reality and economic relations. It conducts its research at a more profound level outdoing traditional microeconomic analysis.

The basis of its attention is relationships that develop within the organization functioning. Neoclassical firm theory and the organization theory consider a company. These theories do not consider internal factors and agents’ interests. In this case the approach is characterized as microeconomic one [16].

Further on, it is worth while saying that there are two types of restrictions in the standard neoclassical theory [17]:

- Physical ones, which are determined by the rarity and limitation of resources.

- Technological ones, reflecting the level of knowledge development and practical experience of economic agents, in other words, this is the level of quality which turns resources into the final product.

Above all this, neoclassical theory ignores the institutional environment peculiarities, as well as the preparation and maintenance expenses of transactions [18]. There is a belief that all resources have their owners. Neo-institutionalism considers the resources to be mobile. Owners’ rights are distributed and protected by law. All market agents have adequate information, etc.

Neo-institutionalism introduces another restriction format caused by institutional (legislative) society organization which also narrows the range of individual choice. The essence of neo-institutionalism arises out of the following facts: it is emphasized that economic agents within the market and society operate in terms of significant transaction expenses, legally restricted rights of property agents, unreliably made deals and inadequately executed contracts, as well as imperfection and incompleteness of information, risk and uncertainty [15].

Besides, neo-institutionalists offer a more realistic approach to the decision-making process. The standard neoclassical theory represents individual as a very rational human being who makes thoughtful, realistic and reasonable solutions [16]. Neo-institutional theory considers the most important human behavioral determinants that is people’ lack of rationality (making wrong decisions in conditions of limited choice) and opportunistic behaviour (main thing is personal profit).

Lack of rationality can be determined by human intellect. A human being’s knowledge can not be full and absolute. Computational and predictive capabilities of people are not unlimited. Logical operations require some effort and time [19]. That is why it should be mentioned that the information is a resource requiring certain expenses. That is why agents can not have the optimal solution and those solutions that seem to be more acceptable depend on the information given [17]. The rationality of agents is expressed in a quest to save both material costs and their intellectual efforts. In this case under all other conditions the agents will prefer solutions that meet fewer requirements judging by forecasting and counting possibilities.

Opportunistic behaviour of economic agents is determined by O. Williams. According to his definition “This is prosecutions of personal interest, near to

perfidy” [20]. In this case, we are talking about all forms of infringements, failure to undertake the obligations and breaking of contract conditions by agents.

Subjects of economics may demonstrate opportunistic behaviour in order to maximize their usefulness, (e.g., provide services of low quality and volume) if they get more profits. Opportunism isn't traced in the neoclassics, because of adequate and absolute information. This is due to the fact that most of the institutions (traditions, customs and laws) are to reduce the negative effects of opportunistic behavior and lack of rationality. In his works O. Williams also emphasizes the fact that less reasonable and moral individuals especially depend on social institutions [20]. There is no need in social institutions in case of the absence of opportunistic behavior and lack of rationality.

Neo-institutionalism formulates objectives for regulatory analysis quite differently. In Orthodox neo-classics absolute competition market model was taken into consideration when assessing the actual sector of the economics and the economic mechanisms of market [13]. All the deviations from this model are considered to be “market failures” and the problem should be solved at the state level. It should be noted that the state itself is to have all the information for it operates out of competition.

Neo-institutionalism does not accept this approach. H. Demsetz called “nirvana economics” the comparison of actual imperfect institutions with the perfect ones that have not reached ideal standards [18]. Subjective evaluation of existing institutions should be based on real alternatives that can be realized in practice and not on imaginary construction. In terms of neo-institutionalism normative analysis should be carried out in a comparative institutional perspective from different point of reference. In other words changing of norms and control figures leads to the change of various traditional forms of economy state regulation in estimation.

Neo-institutionalism removes various restrictions that are typical for traditional neoclassical models. It also applies the principles of microeconomic analysis in those fields that had been prescribed to classic institutionalism and Marxism. All these facts make it possible to regard Neo-institutionalism as a generalized theory of neoclassical economics [21].

R. Coase, O. Williamson and other theorists of neo-institutionalism define neo-institutionalism as a revolution in economics [6, 22]. They believe that this is a competitive theoretical economic system that is

incompatible with neoclassical orthodox theory and can replace it in the nearest future. However, there are scientists who do not agree with this theory. For example, R. Pozner considers neo-institutionalism assessment to be overestimated. In the economic analysis of institutions, R. Pozner considers neo-institutionalism only in the application to classic theory of microeconomics [23]. It should be noted that the theoretical determination of neo-institutionalism has not been completed yet and there is no internal homogeneity. There are terminological and conceptual differences in individual approaches.

O. Williamson is a leading neo-institutionalism scholar who proposed the following neo-institutionalism approaches [20]. O. Williamson believes that technological orientation is more characteristic to neoclassical concept rather than that of contractual one. From his point of view, it is assumed that the subjects exchange occurs immediately and without any expenses. Made bargains are not broken, concluded contracts are strictly and rigorously performed and the boundaries of the of economic institutions impact are determined by the nature of the technologies used [24]. Unlike neoclassical theory neo-institutionalism is determined by organizational and economic (contract) perspective [13]. Organization costs accompanied by the interaction between economic agents not technological factors are the basis.

CONCLUSIONS

Analysis and systematization of the main neo-institutionalism schools traces its development and spread in science. Today it plays one of the most essential parts of modern economy.

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