Institutions, Economics and the Development Quest

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Abstract. Institutions, crucial for the analysis of how agents deal with uncertainty, have been gaining increasing relevance on the Economic research agenda. In this paper, we analyze the institutional literature that provides insights into different research fields, aiming to explain why this perspective obtains better results than others, in the field of growth and Development Economics. In particular, we stress the relevance of New Institutional Economics as an adequate framework for a broad understanding of development issues.

Keywords: Institutions; Institutional change, Economic development.

JEL codes: B52; O1; D23.

1. Introduction
Institutions have increasingly come to be referred to as the main reason to explain why we observe different economic performances in different countries (Rodrik, 2007). Many authors have pointed out that differences in technology, physical capital or human capital may be the probable causes for those distinct trajectories (Meier, 2001). However, as a close analysis of the literature examined by this paper shows, there is much more lying beyond these causes that may enable growth and development; e.g., at the institutional level.

Institutions have been studied for a long time as major determinants of individual behaviour that may contribute to the performance of the economy. The most systematic studies began with old institutionalists such as Thorstein Veblen and John Commons, who, from different perspectives, alerted us to the essential role institutions have in defining agents’ actions (Rutherford, 2001).

As Ronald Coase, a new institutionalist, argued in 1937, in his seminal paper “The theory of the firm”, the uncertainty intrinsic to agents’ engagement in business relationships leads to the emergence of the so called transaction costs. In other words, the more complex markets and societies are, the more probable is it that agents will engage in some opportunistic behaviour against each other. This is only possible because they do not deal
with each other on a daily basis, thus having the chance to misbehave without being punished. Hence, transaction costs encompass information asymmetry costs, bargaining costs, enforcement costs and other similar costs (Coase, 1937). Thus, these transaction costs and the consequent need for coordination, so that agents receive higher benefits from their collective actions and do not suffer from free riding or individualistic actions that prevent increasing gains, necessitate the creation of institutions (Gagliardi, 2008).

Hence institutions are a key feature in the analysis of how agents deal with uncertainty and externalities of their activities, as they can assist in solving these problems. They are the environmental support in which agents take shelter and which defines how they can behave and what they may expect from others’ behaviour. They offer the guidelines for interaction within society (North, 1990). More importantly, the kind of institutions that exist and the way they are organized and structured are essential in order to explain distinct economic performances. From this general understanding of how important institutions can be in the development and growth of economies, many researchers have started studying institutions in order to explain why some economies are more highly developed than others (Shirley, 2005).

Some empirical examples of distinct economic development trajectories were referred to as puzzles that were not easy to solve. The introduction of institutions in the analysis has provided some new insights for an understanding of those types of divergences. One example is the case of the two Koreas: before their separation in the 1950s they had similar development levels, but after 60 years they are now at opposite extremes in terms of levels of development. Other examples are the ex-colonies, which faced different fates after decolonization. Some achieved higher levels of wealth and development while others became the poorest countries in the world (Acemoglu, 2009).

Many studies have been undertaken, using some of the above examples, in order to understand whether institutions indeed have an impact on economic performance. Several empirical studies have proved the existence of close connections between institutions, growth and development (e.g., Knack and Keefer (1995), Clague et al. (1999), Keefer and Shirley (2000); Acemoglu et al., 2001; Acemoglu and Johnson (2005) and La Porta (2008)). In view of these contributions, the research question we want to analyze is whether there is an advantage in introducing institutions and the institutional framework to explain economic performance and, if so, how this has been used in Development Economics. Moreover, we want to investigate which strands clearly emerge within this specific field, and what are the main models and theories proposed.
Hence, we start with an overview of the main lines of institutional research in order to understand not only its sources and lines of thought, but also the way this stream has evolved through time, giving a broad understanding of the main research focus today. Then, in Section 3, some of the theories relating to Development Economics are set out and their proposals analysed within growth and development theories. That is, we will make a brief analysis of the neoclassical and evolutionist branches. Finally, we will propose and analyze the reasons why institutionalism is a better perspective and framework whereby to integrate theories of development than the other perspectives discussed in Section 3. In Section 4 we propose that New Institutional Economics should be the most suitable theoretical framework for growth and Development Economics. Section 5 concludes the paper.

2. Overview of the main theoretical research lines within economic institutionalism

Although institutions have been of general concern in the literature focusing on understanding society and the economy, only at the beginning of the 20\textsuperscript{th} century was a more systematized approach conceived by some authors in order to understand the role of institutions and their impact at both social and economic levels. Two major strands emerge in this period - one linked to Veblen’s ideas and another one closer to Commons’. The former is based on the definition that institutions are patterns of behaviour, “internal” norms, customs and traditions that agents form in a spontaneous way and which will regulate their behaviour. In contrast, the vision of Commons is to a large extent more legalistic. Although this author still agrees with the definition of institutions as rules that help governing agents’ behaviour, he states that institutions have a legal source and are created by agents’ design, not brought into being in a spontaneous way due to the agents’ regular interaction (Rutherford, 2001).

After the 2\textsuperscript{nd} World War these two approaches to institutions suffered a decline in interest mostly because they lacked the capability to offer tools and solutions to deal with the Great Depression (Rutherford, 2001). Hence, until the late 1960s, institutions lost the preponderance they once had, being replaced by mainstream neoclassical Economics. Only the emergence of the so-called New Institutional Economics (NIE) in the late 1960s and early 1970s restored institutions to Economics. However, it is important to acknowledge that another branch has also appeared among a new generation of economists who have tried to bring the ideals of Veblen and Commons to life. Geoffrey Hodgson is one of these theorists; he has worked in this branch by mostly using the ideals of Veblen through his evolutionary and Darwinian approach to institutions and institutional change (Rutherford, 2008). Still, we
focus our analysis on NIE, since it seems to have met with more success in relation to Economics, and has put forward rather different perspectives which seem to have been more widely accepted and applied in the Economics field (Rutherford, 2001; Furubotn and Richter, 2005).

Coase (1937, 1960) played a crucial role with regard to core concepts within NIE, namely those of transaction costs. He first mentioned this concept in 1937, although only with his 1960 paper “The social cost problem” did it have a significant impact among fellow researchers in terms of placing institutions in the forefront of economic research (North, 1989). The recognition of their importance in managing transaction costs is in clear opposition to the mainstream view whereby institutions are mostly taken as given, without accounting for the fact that with positive transaction costs there are no perfect competitive markets. The acceptance of this new reasoning means that these mainstream models are necessarily flawed and do not resemble reality. The existence of positive transaction costs and imperfect markets is only one of the aspects that separate NIE in particular and Non-Walrasian economic literature in general from mainstream Economics (Bardhan, 1989).

Other key divergent assumptions have to do with the nature of economic agents: in NIE they have bounded rationality, are heterogeneous and do not possess all the information available in the market. If agents are not completely rational, they will be unable to use optimization in their decisions. In fact, many of the strands within NIE assume no optimal behaviour (only adaptative rationality), although some authors try to use this approach in the sense that agents optimize within certain boundaries defined according to their rationality and availability of information (Rutherford, 1995). This is indeed a rather divergent vision of neoclassical Economics where perfect rationality, homogeneous agents and perfect information are almost always assumed in the models. There are still, however, some frameworks within NIE, particularly concerning the usage of mathematical tools, that are common to the mainstream.

As we will see below, among these is the research line on imperfect information theory that uses models to propose and explain how agents can design contracts to prevent opportunistic behaviour on the part of others due to asymmetry of information, for instance. Other frames based on mathematical tools develop game theory models to explain agents’ interactions that will lead to the emergence of institutions. Finally, we have the strand that works on public choice modelling, aiming at explaining how the state, as well as organizations that result from social conflict, influence agents’ decisions and promote the rise or the maintenance of specific institutions that benefits the winning group in a political
conflict, usually the one with most political power. This option for mathematical models seems to emerge from a need to explain in a more consensual way their ideas within the economic community. The main reasons for this option may on the one hand be the usefulness of mathematics in proving some theories, and on the other, the need to regain the credibility that mainstream Economics only seems to recognize for research plans using mathematical tools to explain economic phenomena (Backhouse, 2000). Table 1 presents a brief systematization of these two approaches.

Table 1: NIE and Neoclassical Economics: a comparison

<table>
<thead>
<tr>
<th>New Institutional Economics</th>
<th>Neoclassical Economics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive transaction costs and imperfect information</td>
<td>No transaction costs and perfect information</td>
</tr>
<tr>
<td>Bounded rationality</td>
<td>Full rationality</td>
</tr>
<tr>
<td>Heterogeneous agents</td>
<td>Homogeneous agents</td>
</tr>
<tr>
<td>Endogenous institutions</td>
<td>Institutions are taken as given</td>
</tr>
<tr>
<td>Non-optimizing behaviour (only in some strands)</td>
<td>Optimizing behaviour</td>
</tr>
<tr>
<td>Non-Walrasian in some strands</td>
<td>Walrasian</td>
</tr>
<tr>
<td>Mathematical tools and models (only in some strands)</td>
<td>Mathematical tools and models at the core of the analysis</td>
</tr>
</tbody>
</table>

Source: Own elaboration.

Not all the approaches within NIE fit the synthesis provided in Table 1. After the analysis of the relevant literature, we maintain that some of these streams are very difficult to categorize and do not fit all the identified features. The exception seems to correspond to the first four items, which are the building blocks of NIE.

One of the most prominent strands within NIE is dedicated to the study of property rights. Besides Coase, other authors, such as Oliver Williamson, Harold Demsetz and Armen Alchian are associated with this. Some of the first published papers dealing with this subject are Alchian (1961), Demsetz (1967) and Alchian and Demsetz (1973) (in Nelson and Sampat, 2001; Silva et al., 2005). Williamson is also a key author in this area, with some seminal papers published in 1975 (an extension of Alchian and Demsetz, 1973) and 1985 (Nelson and Sampat, 2001; Gagliardi, 2008). During this period, the main research themes were transaction costs in general and the nature of property rights and their enforcement in particular (Rutherford, 1995). The use of formal law was also a main concern that motivated building a framework where property rights were at the centre of the discussion, with Posner (1981; 1992 in Nelson and Sampat, 2001) a supporter of this formal legal approach. The main idea
prominent in this line of research was that property rights help define each agent’s position concerning the usage of scarce resources and how they must behave regarding the obligations of contractual agreements made with any other individual. Without property rights, cheating, misleading and other misbehaviour would be possible and desirable for many agents. The research into how institutions and changes in institutional environment may help sanction and prevent these attitudes is the main objective of this strand. Williamson also contributed to this area of research by adding new insights regarding transaction cost explanations that, together with the work of Barzel (1989, in Alston, 2008) have helped to uncover and solve issues related to long term contracting, hybrid contracts and other associated business questions. The majority of authors within this strand are associated with less mathematical formalization and a more theoretical study of the economic system connected with the concepts of NIE (Alston, 2008).

This line of thought is connected with another research field, the theory of contracts. Here, the main concern centres on a more specific field intimately connected with transaction costs - imperfect information. Although it still deals with the uncertainty that agents face in their daily actions, this strand focuses more on how agents try to solve these issues by themselves, namely by building frameworks to infer how different information levels influence contracts drawn up by agents. This is considered through equilibrium concepts and by analysing the design of contract possibilities; for instance, Contract Theory derives from this line of investigation (Bardhan, 1989). This reasoning started in the 1970s with Jensen and Meckling, and then developed with many contributions from such authors as Coase, Williamson,1 Alchian and Demsetz. Nevertheless, it was most significantly fostered, in association with a more formalistic approach focusing on agency theory, by e.g. Hart and Holmstrom in 1987, and more recently by Stiglitz, Axelrod, Spence and others (in Bardhan, 1989;Furubotn and Richter, 2005).

This formal way of dealing with imperfect information improved the understanding of this subject, affording many insights into the way agents design contracts and how they may benefit from them. The use of more mathematical tools has helped in this process, offering means of enabling agents to make arrangements between each other. The main proof of this progress corresponds to the emergence of several research results explaining the rise of some institutions, such as sharecropping in developing countries, to avoid the effects of imperfect

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1 Coase and Williamson, in particular, have produced a huge piece of research on these first two strands, establishing a connection between them through the study of firms and their emergence as a way of reducing transaction costs (Nelson and Sampat, 2001; Furubotn and Richter, 2005).
information on economic agents’ usual interactions (Bardhan, 1989; Gagliardi, 2008). We discuss these issues below. However, there is some controversy regarding the implications of the baseline methodology here used, since many advocates of the transaction costs perspective argue that studying this subject from an ex-ante perspective (on the contract design) rather than from an ex-post perception (behaviour of agents during and after the agreement) does not accord with the true spirit of transaction costs analysis (Bardhan, 1989).

Furthermore, following a mathematical (although distinct) approach, game theorists have been using game theory techniques to explain how agents act within the institutional structure. Here, Shubik (1975) is the pioneer, using the definition of “rules of the game” to define institutions. Furthermore, Schotter, in his 1981 book, maintains the idea of institutions as a self-enforcing equilibrium outcome of the game, which means that they may emerge spontaneously from the interaction between agents while the game is being played (in Gagliardi, 2008). From this pioneer approach other authors have gone on to exploit game theory, but using a rather different technique – Evolutionary Games, for example, in Young (1993), which tries to show the paths of the process of convergence to a specific “equilibrium” on conventions, where only one of the Nash equilibriums is most likely to occur. These studies seek a deep understanding of the sources of the emergence of institutions in the economy, and use these evolutionary games to set in motion the necessary mechanisms which operate between agents’ periodic decisions and the environment. Thus, within the game theory perspective, we find some influential works by Sugden (1989;2004), Axelrod (1984), Aoki (1996), Young (1998, in Gagliardi, 2008) and Greif (1989, in Gagliardi, 2008).

Evolutionary theory has also produced contributions in the institutional field, following the seminal work “An evolutionary theory of economic change” by Nelson and Winter (1982). This analysis is much closer to the Veblian theory and proposes a research frame, either in formal or in appreciative terms, very far from the formalized neoclassical methods that some of the previously mentioned authors have been using.

Some other NIE economists have been working on more government-related issues which are associated with the public choice field, particularly Mancur Olson. This author undertakes research mostly within the theoretical framework of collective action, analysing how agents may misbehave by becoming free riders or by forming coalitions that would influence institutional design (Rutherford, 1995; Furubotn and Richter, 2005). In this particular field, generally identified as political governance theory, the design of institutions (referred to above) is not only due to pure interactions between agents, but is also obedient to the their strong determination to change rules and some economic structures directly through
their own particular power. Within this framework the government plays an essential role in designing and offering solutions to collective action problems. This line of reasoning has given rise to another research field that is today acknowledged as very important both for Economics and for political science – the functioning of political institutions. This area has become increasingly more important since mathematical modelling has provided numerous tools to recreate the interactions between groups of agents and simulate how they fight for power relating to institutional decisions (Acemoglu et al., 2005; Acemoglu, 2009).

Finally, it is possible to identify a more historical and general approach to NIE. Here the proposal is to employ most of the methods used in the other approaches mentioned above and try to explain the evolution of institutions in countries, using historical arguments. The main procedure corresponds to analyzing the evolution of a country during the last few centuries and trying to understand what has failed or has succeeded in its development path within the institutional framework. The most important economist in this field is North, who claims that the intervention of the state in the design of institutions plays a major role in the success or failure of one country to develop (North, 1992). His general analysis and effort to prove this point, for example in his book of 1990, along with the usage of elements provided by the other strands of NIE, makes this a more complete and structured framework within which to examine countries’ development. Some other important works in this field are Haber in 1991, Libecap in 1989, Greif in 2005 and others (in Furubotn and Richter, 2005).

From the above we have produced an overview of the principal distinct ways of studying institutions within Economics (see also Table 2) as well as some studies that most genuinely represent each field. Each one uses different approaches and methods of research, but all underline one crucial point: institutions are essential for economic performance and neglecting their study means omitting from the analysis a crucial element that interferes with the economy and its agents’ behaviour.

In order to offer a quantitative perspective regarding the evolution of NIE, Figure 1 describes a simple bibliometric exercise: the relative proportion of this specific literature in relation to general economic literature. The database used for this calculation was taken from Scopus on 26th February 2012, using as a search query “New Institutional Economics” solely for articles in English, and for social sciences field and Economics, Econometrics and Finance branches in particular. The total number of papers yielded by the search was 1,103, published from 1989 to 2011, since this search came up with no articles for the previous years. As for the overall number of papers in Economics, a second query tagged all articles in social
sciences and more specifically Economics, Econometrics and Finance. The total number of articles was 478,507 articles between 1989 and 2011.

### Table 2: NIE strand definitions

<table>
<thead>
<tr>
<th>Theoretical strand</th>
<th>Main research concepts and/or methods</th>
<th>Definition of institution</th>
<th>Authors (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Property Rights</strong></td>
<td>Transaction costs; Law and Economics.</td>
<td>Rules of the game that regulate agents’ actions; Mostly defined by human intention.</td>
<td>Alchian (1961, 1973); Barzel (1989); Coase (1937, 1960); Demsetz (1967, 1973) and Williamson (1975, 1985);</td>
</tr>
<tr>
<td><strong>Evolutionary Theory</strong></td>
<td>Evolutionism.</td>
<td>Institutions as rules, patterns of behaviour; Social rules; Customs, as well as Organizations.</td>
<td>Nelson and Winter (1982).</td>
</tr>
<tr>
<td><strong>Political Governance</strong></td>
<td>Collective action problems solved by collective decision making; Interest groups impact on design of institutions.</td>
<td>Rules that are designed to govern collective action problems.</td>
<td>Axelrod (1997); Mueller (1989); Olson (1965, 1982) and Ostrom (1990, 1991).</td>
</tr>
<tr>
<td><strong>Historical Perspective</strong></td>
<td>Historical analysis of institutions, their evolution through time and impact on actual economic situation.</td>
<td>Rules of the game that are defined mostly by agents and which regulate relationships.</td>
<td>Davis (1971); Greif (2005); Haber (1991); Libecap (1989) and North (1971, 1981, 1990, 1992, 2004).</td>
</tr>
</tbody>
</table>

Source: Own elaboration.
As Figure 1 depicts, the relative importance of NIE in Economics has been increasing over time, attaining 0.35% at the end of 2010, having commenced with just 0.05% in 1989.

**Figure 1:** Evolution of NIE articles in Economics (% of overall papers)

It is arguable whether by using “New institutional Economics” as a query, many papers belonging to the field might have been missed within this search. In fact, one might consider that NIE, the term coined in the 1970s by John Williamson (Hardt, 2009), is too narrow to cover the argument. It may therefore be useful to use a more comprehensive query to clarify whether the exhibited trend is actually observed. For this purpose, we used a wider query, “Institutions”, which collated 10,662 articles from 1871 to 2011, of which 9,755 were from 1989 to 2011. This query is much more generic and will thus include other frames besides NIE, but as we will see in Figure 2, the reported trend displays dynamic behaviour similar to the trend associated with NIE, proving that institutions have become a crucial research field in the last few decades.

**Figure 2:** Evolution of “institutions” articles in Economics (% of overall papers)

Figure 2 shows that the use of institutions in articles suddenly gained in importance at the beginning of the 20th century, which can be explained by the emergence of institutionalism in America. Thereafter it gradually declined until the late 1970s and early 1980s, when it again became a significant research field in Economics. Nowadays, almost 3% of articles on Economics use this term.
If we look at the late 1980s onwards, we see the resemblance between the evolution of “Institutions” and “NIE”: both increased their preponderance in Economics in this period. Both searches prove the increasing influence of institutions and NIE in Economics.

3. **Theoretical growth and development approaches: neoclassical, evolutionary and NIE**

From Section 2 and the idea that institutions are crucial to the understanding of economic performance, we may argue that they are also key variables in understanding why economies attain different economic growth and development levels (North, 1990; Engerman and Sokoloff, 2005; Shirley, 2005; Rodrik, 2007). As we have seen above, institutions help reduce uncertainty in the relationships between agents, and thus reduce transaction costs, providing a better framework for agents to behave adequately (North, 1990; Nelson, 2008). Thus, when agents face a more certain economic environment, knowing what they can expect from other agents, opportunistic behaviour is minimized, the mechanics of the economy become stable, enforcement of contracts is easily solved and coordination between agents is indeed possible.

Moreover, institutions may be seen as sustaining growth through the support they offer to technology, physical capital accumulation, education and all processes linked with growth (Nelson and Sampat, 2001). Without some of these institutions agents will perceive activities in various countries as too risky and thus will not invest as much as they could. Hence, fewer motivating behaviours emerge as agents will produce less, and will not trade with certain countries if, for instance, the enforcement of contracts in those territories is not efficient. If there are, for example, no traditions that praise hard work and/or fight absenteeism, it will be very difficult for a country to attract investment, since potential investors know future returns will be low. These are common arguments within NIE (North, 1989).

However, there are different perspectives on growth and development proposed by other strands in Economics that do not include institutions, at least as the main reason, in the explanation for divergences in economic development. One of these is neoclassical theory. According to this branch of Economics, the explanations for growth and development rely on institution-given growth models and also on a few structural change models (the Lewis model is a traditional example (Todaro, 1997)). These models are based on assumptions that typify the economy and agents in very specific ways, as already referred to above. That is to say, they define rational homogeneous agents that make their decisions by maximizing their profits and utilities. The external conditions are given (usually there are complete markets and all institutions are well defined) so that they only have to react to and explain market prices,
supply and demand values and any eventual exogenous shock. Main neoclassical theories explain economic growth through the accumulation of capital, labour and/or technological knowledge: e.g. the Solow model in 1957, the Ramsey-Cass-Koopmans model and all the subsequent extensions, or the new endogenous growth models that rely on human capital accumulation and on the generation of ideas as main sources for growth (Acemoglu, 2009).

Within these analyses, the main explanation for the low levels of growth is the lack of a minimum level of endowments that makes sustained output growth possible, and which will lead the economy to an equilibrium typified by a reasonable welfare level. This limitation may lead the economy to a poverty trap situation (low output equilibrium) from which countries cannot escape unless there is some external element (the government or other entity) that operates the necessary provisions of endowments or the essential changes to obtain them. This is a claim usually criticized by economists due to its negative proposition that countries will be condemned to the poverty trap fate unless some external aid is provided. Moreover, the demand for lower governmental intervention, only that strictly necessary to enhance the conditions for growth, is one of the strongest claims, as according to these theorists the excessive power of the state and its intervention prevents economic efficiency and restrains investors from investing in that country (Todaro, 1997). However, this may be counterbalanced by the endogenous growth theory that grants a role for the state to provide conditions for human capital to flourish (Todaro, 1997). Despite this, some authors argue that less developed countries are held in an unpleasant poverty situation only because they are not able to coordinate the allocation of resources due to the “heavy hand” of the state (Todaro, 1997). According to these theories, there is no scope for other explanations than those of misallocation of endowments that are insufficient and/or are not used in a suitably efficient way in these countries. Any reference to external variables, such as institutions, infrastructures, culture or imperfect markets is usually rejected as they are considered subsidiary questions that do not play a vital part in these theories’ analysis.

These theories clash with the so called evolutionary theory. As we already know, this theoretical approach has some links to the NIE, as some of these last strands closely follow the evolutionary doctrine – as Nelson and Winter (1982) propose. Within this approach Economics is broadly understood by using the evolutionary analogy, based on variety, replication and selection. In the centre of this analysis is the firm, which is the element that causes the economy to move forward. It is assumed that firms are heterogeneous and decide according to a set of rules that do not depend on maximization processes, with these processes (routines) tending to be stable. However, they may change during the process of innovation
that firms implement when they have to face changes in variables such as prices or new rules from competing firms (Nelson and Winter, 1974). Hence, new goods, networks, production protocols and human skills may appear (Foster and Metcalfe, 2011).

These changes do not all occur in the same way, but represent a variety of decisions that are more or less efficient depending on the effects they will have on the level of profits attained (uncertainty is faced by firms according to their decisions). This process, known as selection phenomenon, will define which firms prevail in the market and which disappear (Nelson and Winter, 2002). Moreover, there is no equilibrium level in the sense of a continuous flow of innovation that keeps firms and the economy moving in new directions. Thus the evolutionary process comes from the interaction between innovation and selection resulting in an environment in which only the most efficient firms prevail, giving scope for better routines to be used, which means more efficient production and hence more output and more wealth.

Also important within evolutionary Economics can be the role of the entrepreneur (Nelson and Winter, 1982). Since Schumpeter, the entrepreneur has been conceived as the element that drives the innovation process by imposing “development from within” (Schumpeter, in Foster and Metcalfe, 2011). Hence, the entrepreneur plays a crucial role which involves taking risky actions by investing in some specific innovation that may or may not succeed. It is through his/her initiative that technology advances and the necessary economic transformation and creation of new products and routines emerge, allowing for efficient production.

Besides these theoretical frames, there is another approach that takes some procedures from these latter two, but extends and analyses growth and development issues differently – the NIE perspective. This proposes a set-up where, due to the existence of transaction costs that may restrict the role of the entrepreneur, for example, institutions play the central role in defining the fate of countries. Contrary to neoclassical theories, it does not take institutions as given. It claims that they are the reason why some countries can develop, as their institutional framework fosters efficient agents’ behaviour, while others face difficulties as their institutions do not prevent abusive behaviour and inefficient methods, so that investment is discouraged and agents are restrained from making agreements with each other in a systematic way. This denies some benefits that specialization brings, since the more specialized agents are, the more are agents exposed to others, as they need to buy and sell products constantly (North, 1990).
Within NIE, until the 1990s, there were many analyses of institutions related to Development Economics that did not have the expected impact on this field as they emerged mainly from the ideology of neoclassical theories (Meier, 2001). Only then did mainstream Economics, due to the failures associated with its initiatives in fostering development and growth in less developed countries, start considering the role of institutions (Chang, 2006). The main agreement that emerged concerning Economics was that a country without institutions, or with poor ones, will fail to reach the level of development that others with the same initial conditions will be able to attain (Rodrik, 2007).

In spite of these improvements, the study of institutions and the understanding of their importance for economic and human development is just at the beginning of a long journey (e.g., Jones and Romer, (2010)). Much more research is needed in order to obtain a comprehensive view of institutions and to understand why some countries manage to have better institutions than others, with several questions emerging when we try to disentangle this huge issue concerned with Institutional and Development Economics. For example, some questions may be raised as to why some countries, with similar historical roots, have followed divergent paths, with some attaining higher levels of wealth while others remain stagnant or even grow poorer. Other questions may be asked; e.g. why so many countries seem unable to reform their institutions in order to provide better ones or why, when new institutions are finally in place, they obtain completely different results across countries, fostering development in some and preventing it in others. And we could go on to raise more and more questions that we can easily follow up when we unravel this central issue regarding institutional and Development Economics.

From the several perspectives referred to above we will further extend our analysis to NIE in the next section. As our intention is to contribute to increased accuracy and effectiveness in terms of development theory, we will present arguments in relation to the insights added by NIE, which may complement and overcome some handicaps of other theoretical proposals.

4. Institutions, economic growth and development: NIE as a suitable theoretical framework

To understand the relevance of NIE as an adequate framework in which to explain growth and development, we must first regard the premises of NIE and consider how they correspond more closely to reality. The heterogeneous agents’ hypothesis, for instance, is very important
because each person has different preferences and cognitive abilities, and reacts differently when facing the same event. Thus, different people involve different outcomes that will jointly lead to a specific one that can vary depending on which group of people is affecting it. This is what social realm is all about and why we cannot effectively predict economic outcomes, although we may have the ability to determine tendencies. If there are different groups of agents with different beliefs and different experiences taking economic decisions together, then the “equilibrium” attained may differ from other groups’ decisions. Therefore, in groups where certain kinds of agents with certain specific types of beliefs constitute the majority, outcomes will tend to be closer to the will of this majority. This is not straightforward, since each agent individually also has personal interests that may affect his actions so that in a specific case he may not follow typical behaviour patterns.

Let us think, for instance, of the usual assumption of homogeneous agents and the calculation of common utility function. Consumption is usually the only decision variable, but we know that many other variables may be weighted by agents while making their decisions, such as altruism, self-imposed constraints and personal objectives (North, 1990). Moreover, each agent weights them differently according to his preferences, personal history, culture and other constraints that influence his decisions. Thus, the neoclassical approach of maximization and calculus on the margin may be very far from reality, as agents tend to react by weighting their own beliefs rather than by simply using some standard maximization of consumption (North, 1990). This can be transposed to countries and to larger groups of people that share an identical set of beliefs, but who each have their own personal norms. This will mean that solutions within a country will not be predicted a priori and that in the case of two or more countries they will also not be equal, encompassing different features that will shape the development path of each one.

Moreover, the assumptions of bounded rationality, existence of transaction costs and an imperfect information environment, from the studies referred to above, better resemble the real world in which people live – we remember the pioneer study of Coase (1937) and the empirical proof stated by Wallis and North (1986) of the existence of non-zero transaction costs. Therefore, these studies and NIE enable more accurate analyses of the economic system. Of course, we can counter argue that the usual neoclassical models are just instruments for providing some knowledge of and insights into how some specific variables behave: simple representations of reality. Nevertheless, they will lack the essential point of being applicable to the economic system, since the conclusions are only valid for some particular conditions and may fail when replicated in the actual world. This is more striking
within Development Economics, since there are still many underdeveloped countries and identical policies do not have the same result in different places (Rodrik, 2007). This leads us to the next crucial assumption related to the endogeneity of institutions. While other theories regard institutions as non-economic variables that are taken as exogenous, NIE tries to endogenize them because they are not stable or perfect, but rather imperfect and subject to change depending on agents’ decisions and interactions, and on unexpected events. Thus, as agents are heterogeneous in relation to each other and more extremely from country to country, it is expected that institutions will also differ from country to country. Employing models and studies where this is not taken into account will flaw conclusions, or at least will damage the standard implications while policy recommendations are being submitted.

More explicitly, consider that we have two countries very similar in physical, human and technical conditions. They are both underdeveloped and require a plan to boost their economic performance. Following the prescriptions of neoclassical theory, we would find out what the main handicaps of these countries were (which we are assuming would be the same as they have similar starting points), use the same model and expect similar outcomes in both countries. Neither would the results be those expected in most or all countries where these model recommendations were applied, nor would similar countries meet with the same fate, since we empirically observe quite divergent paths for countries where the same types of policies were implemented (Easterly, 2001; Rodrik, 2007). Why this happens is a hard question to answer. But we know that, besides all the problems involved with focusing on a specific idea and directing aid to one specific point, we must also consider that agents are conditioned by the existing institutional framework. Let us take the example of aid conditional on investment, or on reforms.

If we assume perfect and easily divisible institutional structures and homogeneous and rational agents, these policies regarding investment and reforms would at least have some success. Investment aid would be organised to be appealing for agents to invest, enabling them to promote some industries. The same would happen with reference to policy reforms. We would expect that any change in a policy would be absorbed by agents who would accept future decisions without any inertia in accepting them. This would more or less apply in a perfect world, though not in ours. In the real world, we must take into account at least the assumptions concerning agents and the economic system stated by NIE. And these assumptions mean that agents react differently to these incentives and that the institutional environment will strongly affect the expected outcomes.
Investment is dependent not only on financing, but also on the environment which surrounds firms in a given country. If property rights are not respected, if there is no enforcement of contracts either by parties or by a third party, if some obscure interests are prevalent and exploit the gains made by other agents and firms, if there is no security and no informal constraints that encourage agents’ good behaviour, no one will be interested in investing in these countries and the investment made will just be a flame that will soon flicker out, leaving behind it empty buildings and unfulfilled expectations.

As for reforms, according to North (1990), we must be aware that there is a myriad of rules (formal and informal) that constitute the framework in which agents behave. And these rules are interconnected. While informal rules provide structures for behaving in situations where formal rules are absent or where they are a complement to the latter, both are established by the historical interaction between agents and are interconnected by a complex hierarchy. Therefore, to change formal rules in order to perform a structural reform we would first have to effect a profound and complex change to the hierarchy of rules that would also imply an interference with informal rules that are the basis of any societal organization. If reformers succeed in changing the complexity of formal rules it will not mean that the outcome they envisaged will take place. Indeed, if the reforms come into conflict with the culture and historical habits of agents, informal constraints may force one to reverse those new rules, leading to a process of adjustment until a new state, less radical than the previous one, is brought about.

So far (then), we already have some arguments that dismantle the theory of neoclassicism as the most efficient means of studying development and growth. However, we still need, in line with previous sections, to contrast NIE arguments with evolutionary theory. Firstly, we need to understand that in evolutionary Economics the firm, as a primary element that contributes to the economy with new innovations, will also play a central role as a source for development. The same is the case with the Schumpeterian view of the entrepreneur as the central motor of development, since it is the innovative agent that spreads new ideas and leads to innovations that are the foundation of progress. However, in both cases, the institutional framework exerts a decisive influence on firms’ and entrepreneurs’ actions. As Naudé (2011) points out for Development Economics, there are other more binding constraints that “asphyxiate” poor countries, namely institutional structure and market failures. Indeed, institutions are the cause, and at the same time the consequence, of firms’ and entrepreneurs’ behaviour.
Let us take as an example all the sources of transaction costs and the enforcement conditions that were explained before and which are, to some extent, lacking in underdeveloped countries. Again there are no conditions for firms to invest and evolve in such forbidding environments. The same is the case with entrepreneurs, who see their scope of action shrink, since for instance if there is no patent protection their ideas may be usurped by other agents, or even assuming they can conserve them, they may be unable to put them into practice (since there is excessive bureaucracy, monopoly powers stall their intentions and there is every other type of imaginable constraint). We can counter that entrepreneurs are also the ones who help change the existing institutions. That may be the case, but it is also the case that they cannot do it alone, and we must consider that there are many other entrepreneurs or firms that may be competing with each other in order for their ideas to succeed in the economy. So the process will not be that easy and would mean conflicting parties reaching an agreement. In addition, most of the formal rules management is conducted by politicians, and the strength agents alone, or firms, have is much reduced. Lobbying or forming interest groups is a possibility that will yield better results (Davis et al., 1971).

Moreover, by assuming a forward and backward feed on the variety process, the institutional framework will at some stage define what innovations will be chosen by firms and entrepreneurs, since they will find that not all will be accepted by the other agents’ culture, informal conventions or any other self imposed conditions. Another factor that eases the role of entrepreneurs and hence its relevance to Development Economics is that many economists have now discovered that entrepreneurship is important for development, but is not the first priority. In addition, it is said that developing countries lack the entrepreneurial kind that is useful for development. This type, the one directly linked with up-to-date innovation, is more common in advanced countries because these countries work on the production frontier, which brings new technology that leads to growth (imitation is a possibility, but does not afford the same growth pace as new technology) (Naudé, 2011, pp. 34-37).

In conclusion, we observe that evolutionary Economics may be important for an understanding of some features of development, but it lacks some key characteristics by mostly narrowing the institutional framework. The major form of institution is the firm and its own internal features, as Coase (1937) mentions, as being the element that emerges to overcome the existence of transaction costs. This is without doubt an important factor, but it lacks the very eclectic features of institutions that are external to the firm. Indeed, these have a strong influence both on the firm and on the economy, very significant in terms of a firm’s
We need to expand the scope of analysis and include other institutions and then connect them with firms so that we can infer how they can also be a source of institutional change. This could be a step forward in the standard evolutionist framework. This is an improvement, since e.g., Nelson and Sampat (2001) and Nelson (2008) present their work by taking a similar approach. In these studies there is an integration of firms and social technologies not only as elements of change in the institutional field, but also dependent on this setting. In these recent evolutionary proposals, there is a movement towards institutions, which means that the study of institutions and their inclusion in development arguments are central. This movement implicitly means that there is some need for change from the previous approaches and that the further emphasis on institutions is seen as a crucial measure for changing it.

In conclusion, considering all the arguments used and all the explanations provided throughout the previous sections and paragraphs, we argue that a theoretical paradigm for use in the study of economic growth and development must definitely include institutions as a main determinant. Therefore, we will now present the most important perspectives on development within NIE. According to Gagliardi (2008, pp. 418) and Jameson (2006, pp. 370-371), there are three main approaches to the study of institutions in the ambit of economic development: a “historical perspective”, a “comparative institutional analysis” and “imperfect information theory”.

The first strand, the “historical perspective”, argues that the reason why some countries are mired in poverty is due to their historical path that has undermined their institutions and produced an institutional structure that has become hard to transform – path dependent institutions. Thus, the past of each country becomes a key factor in tracing the reason why they have ended up with such kinds of institutions which are historically specific. It follows that the argument of path dependence is very important in this framework and explains why countries meet with different economic fates. In addition, still following the line of this path dependence hypothesis, North (1990) advocates that only through changes in policy is it possible to reverse the situation, although many argue we need to know exactly how such changes can be made, i.e. what actions are the most suitable for achieving such a purpose (Gagliardi, 2008). From the initial studies of North, many different explanations emerge as causes for underdevelopment. According to Shirley (2005), there are four main explanations for this situation: “Colonial Heritage”, “Colonial Heritage Plus”, “Political Conflict” and
“Beliefs and Norms”. North is closer to the first, although he also draws conclusions from the last one.

As regards “Colonial Heritage”, the main assumption is that different colonial powers established different types of institutions in their colonies. For instance, La Porta (1999;2008) argues that differences between common law (Anglo-Saxon) institutions and civil law (France) institutions led to better institutional bases in some countries (common law group) than in others (civil law group). However, this argument was contested because if for some colonies it is a fact, for others, mainly African, Caribbean and Asian countries, the theory does not offer solutions (Shirley, 2005). A similar situation occurs in the example given by North (1989;1990), when he compares Spanish and English colonies. He also considers that Spain had a more centralized government that did not favour the development of markets supporting institutions as in the case of England, where there was more colonial autonomy.

As for the second explanation, “Colonial Heritage Plus”, there are some similarities to the first one, but here the great debate is whether colonisers brought to the colonies the best institutions available or if they pursued purely exploitative behaviour towards their colonies. This is argued by Acemoglu et al (2001) and tested in Acemoglu and Johnson (2005). The main arguments are that in locations where colonial powers benefit from good weather, soil, lack of disease and land conditions, they were able to establish large communities. Where there were huge quantities of natural resources and a sufficiently large population to exploit, colonies were established just to exploit the wealth of that specific area. The institutions created were only those necessary for the maintenance of power and the extraction of as many resources as possible from the native population. In other colonies, where larger colonial populations settled, institutions were shaped in a more favourable way as migrants wanted to assure (and secure) their rights and properties, and where their customary behaviour would not be affected by damaging laws and policies. These are the main reasons why countries such as the USA and others were established on the grounds of good institutions, while others, such as most African and Latin American countries, maintained a poor institutional basis (Acemoglu and Johnson, 2005; Shirley, 2005). Engerman and Sokollof (2005) also support this view, although they argue that institutions are dependent on the endowments that were available in each country when the colonies were established. Both views have been contested, since they seem to miss some crucial points in terms of the Colonial Heritage explanations. They do not give relevance to the kind of colonial power established in those areas but only focus on the natural endowments of those areas and their impact on the
institutions established there. Moreover, they can only explain some specific cases, such as the emergence of the USA (Shirley, 2005).

The third explanation, “Political Conflict”, is in respect to the lack of political conflict as the source of poor institutions. Here the conflicts correspond to situations in which, to fight some common enemies, elites unite and forge alliances so that together they are able to win the conflict. These alliances comprise concessions of power and laws that favour some elites and make previous institutions change to accommodate those concessions. Some examples are the concessions the English king made to English the nobles and merchants in order to receive the financial and human support needed to expand the empire. These alliances changed some previous statuses, decentralizing some of the previously exclusive power of the king by, for instance, giving more power to the parliament. Thus, these conflicts enabled the appearance of certain institutions.

Within this third explanation some authors argue that, since African countries already had defined boundaries after decolonization, they did not have this kind of political conflict, with the rigid international laws restricting any conflict outside boundaries. There is no agreement as to whether this conflict theory would have applied to these countries, since many reasons lie behind the underdevelopment of Africa, and all these other explanations cannot be forgotten, as they may really have a word to say regarding the process (Shirley, 2005). Another possibility lies not in the conflict between insiders and outsiders of a country, but between elites in the same country, as Nugent and Robinson (2010) emphasize. They state that competing elites make agreements with smaller entrepreneurs, giving them support (more rights within a new institutional design) that makes these entrepreneurs more efficient and hence promotes growth. However, this specific case is difficult to generalize (Shirley, 2005).

Finally, the last explanation, “Beliefs and Norms”, relies on the reasoning that each country has inherent beliefs, norms and customs that could render a “fertile land” better or worse for good quality institutions. On the one hand, some argue that these informal rules may in themselves prevent the establishment of some institutions due to their strong prevalence in people’s minds. One example is the Protestant incentives for production, entrepreneurship and other qualities linked to the ideals that made the industrial revolution possible (Shirley, 2005). Others, more restricted in their analysis, refer to these rules as elements that may stimulate better learning and implementation of new institutions or that may prevent them, depending on whether they come into conflict with each other or not. The main flaw in this analysis is that apparently there are no solutions for systemic beliefs that prevent institutions to arise, thus condemning less fortunate countries to even greater poverty.
The change in beliefs seems as a hard task that can be accomplished through investments in education and increases in wealth (Shirley, 2005). Why? Well, one hypothesis is that people are more willing to accept new institutions and changes in their behaviour if they have a better way of life. Economic and social well-being means improvements in welfare that will soften people’s reactions to change as they become less doubtful and less worried about the impact those adjustments will have on their lives. In addition, the better educated people are, the better they will understand which changes are most beneficial, hence leading them not to reject them due to lack of understanding or fear of the unknown.

Within these hypotheses is an ultimate assumption: path dependence. The meaning of path dependence is that future and present outcomes are intimately connected with past events. It can be said that today’s institutions have links to previous ones and to the events that originated them. This is significant because new institutions will be organised according to the kind of event that was the source of their emergence. This implies that when those institutions follow a certain path, such a trajectory will influence the country’s performance for the following periods, unless some adjustment changes the course of events (North, 1990). Thus, path dependence is very important, as it may determine whether countries diverge or converge. Taking one of the examples above, as a result of the colonial period, today’s developing countries have different kinds of institutions that have defined their post-decolonization paths. Some were able to achieve convergence, as was the case with some former colonies of the United Kingdom, while others diverged, as in the case of former Spanish colonies (North, 1989).

Outside this area, the “Comparative Institutional Analysis” has made some progress in explaining differences in institutional outcomes. Such explanations are along the lines referred to in Section 2 as being connected with game theory. Hence, it is divided into evolutionary games and repeated games. It does not dismiss the historical perspective, but rather links both historical and comparative perspectives to create an aggregate view.

The Evolutionary Game theory treats institutions as the result of continuous interactions between agents, which in contrast with the "Historical Perspective" means that there is no need of a third party to guarantee the establishment of institutions (Gagliardi, 2008). Therefore the main characteristic is that, when modelling, the result will be a single equilibrium where a specific norm will be followed by the majority of agents as the best response to it, the norm itself making it self-enforcing. Some particular aspects are studied by

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2 Path dependence is discussed in many works, such as: Puffert (1999), Crouch and Farrell (2004), Schwartz (2003), Collier and Collier (1991) and Page (2005) (in Gagliardi, 2008).
Young (1993), namely the impact of the past on agents’ decisions, as it plays an important role by imparting extra information that is not “freely” available, as agents live in an imperfect information world.

As regards Repeated Games, there are two main areas of research, viz. the emergence of organizations that have the role of changing rules, and the way in which these rules constrain the behaviour of agents (Gagliardi, 2008). Hence, there is a strong intent to define rules through those organizations within the frame of beliefs that exist in society. The idea is that by interacting regularly, agents can create mechanisms (organizations) that help them coordinate their actions and hence benefit them as a whole.

A unified approach is proposed by Aoki (2001, in Gagliardi, 2008), whereby the author reconciles both views of the “Comparative Institutional Analysis” strand. He considers that institutionalization can even be achieved by both autonomous mechanisms and agents’ will, which must still be an equilibrium outcome (evolutionary requisite) of the game because otherwise it will not be sustainable in the long run. In this frame, two possible approaches are proposed. Institutional linkage is the first, whereby it is recognized that when people are connected in a domain it is easier to cooperate in other domains also, thus expanding the choices available, which will facilitate the appearance of new institutions. Institutional complementarities correspond to the other approach, whereby the interdependence of institutions is studied in the sense that the impact of an institution is bigger when there are complementary institutions that reinforce the influence of the first one (Gagliardi, 2008).

Finally, the last strand proposed regarding the study institutions in the context of economic development is the “Imperfect Information Theory”. The reasoning behind this maintains that institutions are the pieces that solve the jigsaw of the missing markets and preclude the emergence of complete markets by minimizing imperfect information. This corresponds closely to the perspective referred to above within the main strands of NIE, but now specifically applied to the field of Development Economics. The most important research within this field aims at an understanding of how institutions emerge in developing countries to overcome missing markets. The first study involved sharecropping in developing countries, an institution created to overcome risky investments (Bardhan, 1989). These types of institutions that emerge rather spontaneously are the solution for undeveloped countries that are sometimes disregarded as unimportant by reformers. Moreover, very often reforms end up causing disillusionment because by forgetting how important these institutions are they eliminate a mechanism within the economy that is the key element which has maintained economic conditions above the inefficiency line (Bardhan, 1989). Many others have been
interested in these studies in other contexts, such as interlocking of transactions, labour tying, and others, concerning which there is a lack of empirical studies, according to Nabli and Nugent (1989, in Gagliardi, 2008). Even given the need for further empirical examination, this field of study has been important to the extent that it has enabled us to understand the way in which institutions arise because of the need people have to manage lack of markets or imperfect ones. Although they may not be the most efficient solutions, these institutions are undoubtedly the best possible remedy when one considers the other paths available where no institutional arrangements arise.

To sum up, we have seen three distinct strands in economic development that are related to the more general strands of NIE. Despite the differences, these approaches are somehow complementary, because without a historical analysis it is impossible to understand both the implications of countries’ origins and their institutional inheritance. However, such an analysis is not in itself enough. It is also important to understand how institutions emerge from the constant interaction of agents, how they change and how they are accepted by a society. This may give us insights into how to introduce the “right institutions” in order to improve economic performance, but the answer will not be provided by adopting these approaches individually. Furthermore, if the first two strands are necessary, the third one will also have relevance, as it studies the invisible power of human need, proving that institutions are created due to the lack of better and more efficient solutions. Moreover, this last strand warns about the adverse consequences that can emerge if these institutions, on a blind quest for reforming policies, are eliminated, or damaged, and if no others take their place, leaving entire populations without the only safety mechanisms they have known. This would cause a setback to the development process instead of fostering it. In Table 3, following the layout and the frame proposed by Shirley (2005), we present a systematization of the main economic development perspectives within NIE.

Once more using a simple bibliometric exercise, we offer a quantitative perspective concerning the relevance of NIE in the field of Economic Development. We again use the Scopus database. Figure 4 represents the search undertaken using “New Institutional Economics” + “Economic Development” as a query in the subjects of Economics, Econometrics and Finance, which produced 395 articles. We observe that the volume of Economic Development research within NIE has remained almost stable during the last two decades.
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<td><strong>Historical Approach</strong></td>
<td>Colonial Heritage</td>
<td>Colonial countries left their institutional mark on their colonies;</td>
<td>North (1990)</td>
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<td></td>
<td>Colonial Heritage Plus</td>
<td>Different legal methods influence institutions.</td>
<td>La Porta, Lopez de Silanes, Shleifer and Vishny (1997, 1998, 1999); La Porta, Lopez de Silanes and Shleifer (2008); Acemoglu et al. (2001); Engermann and Sokoloff (2002); Nugent and Robinson (2002; 2010)</td>
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<tr>
<td></td>
<td>Political Conflict</td>
<td>Initial conditions and subsequent institutions determine the future.</td>
<td>Bates (2001); Herbst (2000)</td>
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<td></td>
<td>Beliefs and Norms</td>
<td>Beliefs and norms intrinsically related to each country may prevent new institutions or at least have a decisive role in filtering them. Culture also plays a role.</td>
<td>North (1994, 2004); Greif (1994); Knack and Keefer (1997); Bednar and Page (2005)</td>
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<tr>
<td><strong>Comparative Institutional Approach</strong></td>
<td>Evolutionary Games</td>
<td>Institutions emerge spontaneously and result from the interaction of agents that accept them when they are the equilibrium.</td>
<td>Aoki (1994, 1995, 2001); Greif (1998); Okazaki and Okum-Fujiwara (1996) and Young (1995)</td>
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<td></td>
<td>Repeated Games</td>
<td>Institutions emerge by design of organizations that emerge according to the will of agents, due to coordination efforts.</td>
<td>Aoki and Dinc (1997); Falchamps (1996); Greif (1989); Greif, Milgrom and Weingast (1994); Aoki (2001); Spagnolo (1999) – an application; Platteau and Seki (2000);</td>
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<td></td>
<td>Mix</td>
<td>Complementarities.</td>
<td>Aoki (2001); Hall and Soskice (2001) and Boyer (2005)</td>
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Source: Adapted from Shirley (2005).
However, it is interesting to observe that 35% of all NIE literature is dedicated to some extent to economic development. This indicates some relevance of the research into economic development within NIE, backing our previous analysis.

Finally, as in Section 2, we analysed the use of the term “Institutions” in the field of Economic Development, applying the query “institutions” + “Economic Development” to the search, which resulted in 6,952 articles for the period 1989 to 2011. There has thus been an increasing frequency of publication (see Figure 6), and while the relative weight of “NIE” corresponds only to about 2% (Figure 4), the subject of “Institutions” is now stabilizing at approximately 30% of the total literature on economic development.

This means that the subject of ‘Institutions’ has become increasingly integrated and investigated within the economic development field, probably indicating that researchers doing related research consider that this subject can offer new insights into the quest for development and add it to their research topics.
5. Conclusion

The main purpose of this paper has been to provide some insights into the literature concerning institutions and economic growth and development, by asking what the main advantages of using such a framework are, instead of adopting other perspectives that attempt to explain economic performance without using institutions as a determining element. We have shown that the relevant literature has already proved that institutions are essential for understanding and explaining economic performance. The existence of positive transaction costs and the subsequent importance of institutions were the latest inspiring discoveries that have motivated some economists to dedicate their research to uncovering the particularities and implications of considering transaction costs in several different areas of the economy. There are studies on the historical level, on the law level, on agent to agent interactions, on evolutionary perspectives, on applications with game theory, and on the political level that explain the emergence of institutions and consequently the reduction in transaction costs. All these theories were then applied to the study of growth and development in order to furnish insights into how countries experience different conditions at an institutional level that either enable them to develop or prevent them from doing so, and if the latter is the case, how the negative conditions may be overcome.

This understanding of the importance of the institutional level is not fully introduced into other frameworks, such as the neoclassical and the evolutionary models. Hence, we argue that these approaches should be complemented by an institutional framework to improve and strengthen the rigour of the analysis. As NIE includes contributions of these theories and operates within a specific institutional frame, we argue that it is thus a more valid approach, more able to explain reality and the economic system.

References


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