A Framework for an Organic Approach for the Analysis of Institutional Transplants in the Economic Context

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Abstract: Institutional transplants is the name given to formal institutions which are transferred from one institutional setting to another. They are one of the possible channels for institutional change. The success of an institutional transplant depends on its interaction with its new environment. Previous research, based on the methodology of neoclassical economics (and to some extent - of the new institutional economics), is limited in its ability to predict the success of such transplants. We propose a framework for an organic approach for the analysis of institutional transplants in the economic context, which has a potential to overcome these limitations. This could enable policy-makers to take better decisions when undertaking institutional reforms.

Keywords: institutions; institutional change; methodology; heterodox approach; institutional reform

1. Introduction

Institutional transplants is the name given to formal institutions when they are transferred from one country to another (or, more generally, from one institutional setting to another). Usually, when the transfer is an attempt of imitation and when it is voluntary, the goal is higher institutional efficiency, which leads to a general improvement of welfare[3]. The success of such a transfer is by no means guaranteed. It is the result of a number of factors, among which especially important is the role of the sociocultural environment. Ignoring it could lead to failure of social and economic policies.

The present article states that institutional efficiency for most of the time is of a relative, and not of an absolute character. Efficiency depends on the interaction of the behavioral stimuli arising from the institutional transplant itself, and on the stimuli coming from the general (both natural and sociocultural) environment, which exists at the time of the transfer and where human actions take place. The

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[3] Sometimes institutions are transferred coercively (e.g. by a conquering state) and the search for efficiency takes another context. The goal could be extracting resources more efficiently or keeping the conquered population in submission. The goal is then not the welfare of the natives, but of the conquerors.

ignoring of these factors, hence the failure of the policies is largely due to the chosen methodological approach of analysis, which is usually of a monodeterministic character. This leads to the construction of a limited explanatory framework that serves as the basis for predictions about the effects of a policy, without taking into consideration the complexity and dynamics of the environment. Thus the value of such predictions is eroded. It is especially relevant to policies in the economic area, which are the result of analysis, based on the instrumentarium of the neoclassical economics[1] - methodological individualism, rationality of agents and maximizing of personal welfare (often equated with personal wealth) (see Arnsperger & Varoufakis, 2006; Sugden, 1991; Vanberg, 2004). Here we offer an organic approach, based on methodological pluralism, which could overcome some of the limitations of the existing approach. It can serve as a basis for analysis when borrowing economic policies and as a tool to decrease the errors that accompany this process.

2. Limitation of the Neoclassical Approach for the Explanation of Institutional Change

There are a number of hypotheses that try to explain the emergence of new and the changing of existing institutions (Kingston & Caballero, 2009). These can be broadly divided into two categories. In the first, institutional change is regarded as the result of a purposeful process that is centralized, where the decision is taken by a single figure of power or by many people within an existing mechanism for collective decision-making. In the other, institutions emerge as the result of a decentralized process, akin to the evolutionary. In both cases it doesn't matter whether the institutions were the result of a purposeful design or whether they emerged spontaneously. The only thing that matters is their fitness and efficiency - whether the rules on which they are based leads to the prosperity and thriving of the societies that have adopted them[2].

This categorization is to a certain extent arbitrary, because the dimensions “conscious ” (purposeful) - “unconscious ” (not purposeful) could penetrate both the centralized and the decentralized process of the establishment of new institutions. Conscious actions can have unforeseen consequences and the newly created institutions may take on functions which were not originally intended[3].

[1] Actually, neoclassical economics doesn't pay much attention to institutions. Instead it takes certain institutions for granted (e.g. property rights). Then, discussing it in the context of institutional change may seem out of place. But the new institutional economics (including transaction cost econom

[2] This argument can be traced back at least to Marx (1969), who claims in chapter 1 of "The Communist manifesto" that capitalism destroys the old forms of social organization. Even the most barbaric nations are forced to either become civilized (and adopt capitalist modes of production) or become extinct. They just can't compete economically with the bourgeois society.

[3] Henry VIII overthrew papal authority, when the Pope refused to recognize the king's divorce as legitimate. Probably England's development would have been different, had Catholicism remained the

Meanwhile in the evolutionary process the effectiveness of the respective institutions determines their stability and propagation, compared to other institutional forms, but at a lower level a given institutional form may be the result of a conscious design. Also, decision-makers can purposefully reject an existing institutional arrangement and introduce another, which they expect to be more efficient. That is, the evolutionary process can take place even if there is a conscious criterion for selection.

It is here where we can look for the place of institutional transplants in this categorization, because, as it has already been mentioned, they are institutional arrangements which are transferred from one institutional setting to another. Examining institutional change in the context of institutional transplants, we should rule out the creation of new institutions that do not exist elsewhere, as well as of institutions which exist elsewhere and are not borrowed, but are discovered or emerge independently.

Institutional transplants can be examined in the context of evolutionary theories of institutional change, because the decision to adopt a specific institutional arrangement, which exists elsewhere, should be at least partly related to the belief that this will lead to greater efficiency. Borrowing and imitation is often an effective and resource-efficient approach and institution-building makes no exception. In most cases it is easier to recognize an effective structure than to find a way to build it from scratch. This would allow the transfer of institutions whose final form is too complex to be discovered independently. These are institutions that arise spontaneously and are based on the imposition of a few simple rules that lead to the emergence of a complex structure and mechanisms of interaction. Sometimes it is very difficult to relate the desired form of social organization to the rules which create it. Replication of the “rules of the game” from countries, where these institutional forms exist, gives a partial solution to this problem.

The introduction of new institutions, either by transplanting them or by some other way, could face several obstacles (Kingston & Caballero, 2009, pp. 172–175). The first derives from the “free-rider problem” related to the collective decision-making process. Even if the members of the public realize the benefits of the new institutions, from the perspective of each independent individual it may be rational not to get personally involved in the establishment of the new institutions, but to leave it to others instead. Naturally, given that society is mainly composed by rational individuals who seek to maximize their utility, then the majority of the individuals will act accordingly (i.e. not act) and eventually the status quo will prevail.

official religion there. At the same time the motives of Henry VIII for this institutional change were mostly personal.

The second obstacle to institutional change has a relation to the first one. But the obstacle here is not the presence of free-riders (who have an interest in the change, though no interest in getting involved personally). Instead, it is the existence of groups who have vested interest in the status quo. A given institutional arrangement can bring net benefits to society in general, however there might be losers. Even if the gains exceed the losses, the winners might not want or simply might not be able to compensate the losers. The redistribution effects could lead to resistance to the change. Whether this resistance will be successful depends on the balance of powers, which in turn are determined (among other things) by the existing institutions. Thus, the resources, accumulated under a given institutional arrangement, determine to some extent the available paths for institutional development in the future.

Another obstacle for the appearance of new institutional forms is the interdependence of the old institutions with institutions from other areas of social life, in particular - with other economic institutions. E.g., the automatic transfer of bankruptcy rules for legal persons from one legal system to another will depend largely on the relations and references of this field of the law with the general character of the existing institution of property rights and the specific forms that legal persons take there. Radical changes in some fields can be stultified by the lack of changes in interrelated fields.

The fourth reason that can impede favorable institutional change is the bounded rationality of the agents. What is more, new institutions often appear in a complex and dynamic environment where information is scarce or hardly accessible. Thus people might miss on the opportunity to undertake the change, simply because they don't recognize the advantages of the new arrangement.

The fifth source of institutional inertia and stability of the old institutions arises from endogenous preferences. Existing institutions can influence the behavior of the people, which can result in habit formation, and through that they can affect tastes and preferences. In this way some institutions can become self-sustaining, by reinforcing tastes and preferences which are favorable to the institutions' existence.

The sixth reason for the resilience of the old institutions bears resemblance to the previous. The separate individual affects institutional formation, but institutions themselves shape the individuals. Similar role is performed by the sociocultural environment, too[1]. By filling with content our believes and values, this environment determines the direction and intensity of our desires. The influence of informal institutions may be similar in character to the influence, exercised by

[1] The individual becomes an individual in the society. In the words of Goldschmidt (Goldschmidt, Zweynert, Nerré, & Schuß, 2006, p. 180, col. 2) "...the very process of individualization is to be understood as a process of *enculturation* at the same time. The individual becomes only an individual because of his social learning".

formal institutions in the form of sanctions and rewards. It can do so through mechanism of behavioral control within certain social networks. These mechanisms can be enforced by the members of the network without the involvement of the state or other centralized institutions (e.g. in the form of reputational effects).

The reasons, mentioned above, stand in the way of institutional change in principle, and in particular in the transfer of institutions from one setting to another. However, the problem examined here is a little bit more specific. It is not simply a matter of rejecting new institutions, but a case where new institutions are introduced in a different sociocultural and institutional setting under the assumption that they are (generally) efficient, although the case for their efficiency has been only made under specific circumstances. This is not an argument against the borrowing of good practices and institutional transplants. The justifications to resort to the latter have been already mentioned above. Besides, an institutional arrangement that has proven itself to be efficient in a given setting usually will be a little more convincing in its usefulness than an arrangement, which just looks good on paper but has not been implemented anywhere. However when an institution is borrowed it should be done so with the assumption that its efficiency may be of a relative, and not of an absolute character, and that it is a function of the interaction between the new institution and the other formal and informal institutions that exist in the new setting. Institutional transplants are not novelty in human history, but they have become more topical in the last decades, as the easy access to information has made institutional borrowing faster, without them having proved themselves to be efficient in the first place. Besides, the social, cultural, and economic differences between the borrowing country and the country of origin might be larger than in previous times. (Mamadouh; Jong, & Lalenis, 2003, p. 281)

It should be noted that the first three obstacles to institutional change - free-riders, vested interests, and interrelations between the institutions - are not necessarily insurmountable for the methodology of neoclassical economics[1] and the potential success (or lack of, thereof) of institutional transplant can be explained under the assumptions of rationality, individual utility maximization, and methodological individualism. In most cases it would be enough to take into consideration the influence of the behavioral stimuli arising from the aforementioned three obstacles. It is less so for the other three obstacles - bounded rationality, preference endogenity, and the influence of the informal institutional and sociocultural environment. Then the existing approach faces significant limitations.

[1] The analysis from the point of view of neoclassical economics can be also incomplete, but for another reason. It's actually the opposite problem of the one that has been described so far - why some institutions are adopted, when we expect that they shouldn't. E.g., the conclusion that a specific institution will not be introduced because of free-riders might be wrong if we ignore the motivating forces of ideology and values, which urge the separate individuals to take action (e.g. voting at elections), even though the costs exceed the benefits for this particular action. See North (1988).

The application of the approach offered below questions the existence of efficient institutions, where efficiency is absolute. The efficiency of an institution is relative, it depends on the context. This is twofold. On one hand, efficiency relates to the goals of society, and the goals can differ for the different societies. On the other hand, even with identical goals, but with differences in important aspects of the social environment (economic, political and cultural), an institution that gives good results in one country may fail to do so in another.

The question of efficiency refers less to the question whether the respective institution will provide the same results in the borrowing country as in the original country, and more to the question whether the borrowed institution would bring better results than its alternatives. Allen (2011) gives a number of examples for institutions from pre-industrial England, which from the modern point of view look very inefficient, but they are very reasonable when examined in their context[1]. Actually, the introduction of modern institutions at the time would have been a waste for most of the time.

The hypothesis for the relative efficiency of institutions is especially topical in the context of the prescriptions for economic reforms, encouraged by some international institutions. This applies both to the introduction of new institutions and to the removal of existing ones. With deregulation the relations between market agents are preserved but their conduct and coordination will be accomplished through informal mechanisms, hence the importance of the sociocultural environment will be higher. Although the results from given regulative measures can differ, when they are conducted in different settings, it would be even more so with the results from deregulation. While formal institutions can suppress the informal (and so lead to partial convergence of results), in the absence of formal institutions (i.e. deregulation) the results will depend almost entirely on the informal institutions and the sociocultural environment[2]. Probably the deregulation of an economic sector in Sweden will not lead to the same results as its deregulation in Bulgaria. For example the easy access to information is generally considered to be a positive feature of the institutional environment that makes doing business easier. In the context of the Trade registry such access would allow knowing your (potential) business partners better. In 2011 an argument was started in Bulgaria to what extent such a practice is suitable for the local conditions (Босев, 2011). It was provoked by the increased number of “theft ” of companies where, on the basis of existing documents, new ones were prepared (e.g. records of proceedings), but with changed information about owners

[1] For example, law enforcement was carried out largely by private and quasi-public institutions. Another example would be that public offices were taken not on the basis of the qualities, demonstrated by the individuals, but by the highest bidder. Such practices existed even for army officers.

[2] To paraphrase Tolstoy - regulated markets are all alike, every deregulated market is deregulated in its own way.

and shareholders, thus gaining control over the firm. According to some members of the Parliament the easy access to company files through the internet had made it easy to falsify documents. That is why they initiated legal changes to restrict the access to the Trade registry through the internet with the intention to make it possible to trace who and when had access to the information from the Registry[1].

3. A framework of an Alternative Approach

The approach presented here[2] tries to overcome the limitations, arising from the mono-approaches (understood as determinism of one or a limited small number of factors). Using this new approach as a starting point for analysis one could achieve a better explanation and prediction about the eventual success of concrete institutional transplants in the economy.

3.1. Holistic Polydeterminism

Individual actions are determined by the social environment, but at the same time they influence it in turn, because they are carried out in this environment. The social environment as a factor of development is not limited to a specific type of determinism, but is a mixture of the simultaneous influence of economic, political and cultural factors. The domination of one of these factors at any given moment does not rule out the influence of the others.

The economic environment includes all economic institutions. It has a direct influence on the economic agents and finds its expression in the market and in its regulation, related to competition and economic power. In broader terms it includes the immediate participants, the condition and factors for production of goods and services. The political environment consists of all political institutions. It influences economic development and the economic agents through the entire process of management arising from the political process mainly in two directions. First, as the political power to enforce formal rules and second, as the realization of revenues and expenditures for the provision of public goods.

The sociocultural environment influences the individuals through its institutions, too. It does so through moral, psychological, customs-related and other limitations, imposed during the pursuit of economic interests. One of the main channels of influence, arising from culture, are values. Values are related to goal-setting. Culture can be involved in the formation of new preferences, which the economy strives to fulfill.

[1] Although according to some investigative journalists the motives for this motion were to prevent journalists from finding out the relations between politicians and their family members with companies.
[2] It is a brief overview of the approach, shown in more details in Минчев (2013).

The overall picture, representing the movement of the social system, depicts a continuous struggle for realization of the social subjects by asserting their own goals as goals of the others, depending on the balance of powers. This assertion is modified by the others' strength and is expressed in various ways in the history of society. The clash of interests finds a relative rest in institutions. As it has already been mentioned, the domination of the economic, political or sociocultural environment depends on the way in which these environments interact and on the specific form and development of each one of them.

The social environment, being a mixture of economic, political and sociocultural environment, is the environment where individual and group interests are immersed. It consists of institutions which determine the behavior of the individuals. The individuals are driven by their interests, which they pursue with concrete, inherent for them power, and the institutions - by a system of organizations and rules, which are the result of a compromise and a dynamic balance of the powers of these very same individuals. Actually the institutional setting is a social redefining of the scarcity that exists in nature. Thus, it is either intensified or redistributed.

3.2. An Arganic Approach

The approach is based on three dialectical relations, which serve as a connecting node for three different approaches that are often used separately. These are the dialectical relations between dialectics and eclecticism (the eclectic approach is a form of expression of a continuously changing determinism), between individualism and holism (the many individual actions form the whole, and it in turn - the individual), and between existence and consciousness.

The organic approach suggests methodological pluralism and in the explanation of the human and social development it is based on the dialectical total unity of the human, the social environment, and the natural environment as factors of this development. It depends on the context (the specific time and place) which element of this unity (human, social or natural environment) will dominate. The elements constantly blend and turn into one another, they are in continuous motion. In every moment one of the elements might dominate, but the unity remains. Between the elements and within the elements there are contradictions, which are in unity and struggle and this ensures the motion of the system. The Earth, society and the human are regarded as totalities each, and not just as separate characteristics of these elements.

The organic approach reflects the totality and unity of and interdisciplinary approach, individualism and holism, subjective and objective, deductive and inductive approach. Individualism is necessary in the social sciences because the human is at the basis of every action and condition in society. It is wrong to employ it as the only approach because taken to its logical conclusion, it is a failure of society and replaces society with the laws of the jungle. Holism is necessary in the social sciences, because the whole limits the individuals in their actions. It is inappropriate as the only approach because taken to its logical conclusion, it is a failure of the individual and negation of individual differences.

The organic approach requires also unity of the objective and the subjective. The actions of the individual are subjective, but they are transformed into objective facts. On the other hand, objective facts and processes influence the individuals when they make subjective decisions. What is more, the subjective actions of the many are objective processes for the separate individuals. This approach suggests unity of deduction and induction. When only the deductive approach is used and the inductive is ignored, we are deprived of our initial position for deductive reasoning. If we use the inductive process before the deductive, we can get a better estimation where to stop the process of abstraction.

4. Conclusions

The framework of an approach outlined above has the potential for a richer explanation of the social processes and more specifically - for a richer explanation about the expected results when borrowing specific institutional arrangements. This doesn't mean that it is capable of giving a categorical answer to the question how a new institution will fit in its setting, but that it is a better starting point for the analysis. Nor is it a call to reject the methodology of neoclassical economics. In contrast, this methodology has proven itself in time and it has its applications, but one should consider its limitations and the cases for which it is suitable. The examination of institutional transplants is one of these cases where the limitations are manifested, because the successful transfer of institutions depends on factors, which are not considered by the neoclassical approach - such as the sociocultural environment and the role of habits.

With all its shortcomings the neoclassical methodology has the pretense of comprehensiveness, leaving aside whether the pretense is justified or not. The scientific value of a methodology is higher when it allows to make as many as possible general-case predictions based on the available data and when the data available is easy to measure and quantify. Even when an approach yields ontologically true statements, it might not yet be attractive for scientific work and policy-making. It is probably even more so for the latter, because policy-makers usually prefer straightforward and simple solutions with less conditionalities.

The organic approach gives fulness to the analysis and is more relevant to reality than the mono-approaches (be it methodological individualism or a monodeterministic holism). But at this stage of its development its practical application and its usefulness as a guide for taking concrete decisions is more an art than science, where the evaluation of the ways in which the determinants of social development interact is the result largely of the intuition and the introspective abilities of the analyst. To some extent it is an unavoidable element of the analysis of dynamic and complex systems. Further efforts are required to make this approach fit for empirical work and to transform it into an approach that will allow its transferability as a decision-making algorithm. If possible, this should happen with a minimum loss of its descriptive fullness.

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