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Different institutional behavior in different economic systems: Theory and evidence on diverging systems worldwide

Solomon I. Cohen *

Erasmus School of Economics, Erasmus University Rotterdam, The Netherlands

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ABSTRACT

The paper reviews and criticizes the past and current state of comparative studies of economic systems (CSES) for the lack of an analytical framework to back them. An analytical framework is formulated that allows for a changing distribution and interaction of agents along the subsystems, each of which is characterized by distinct and intrinsic institutional rules. The framework studies the convergence of agents and institutions toward the dominant subsystem and behavioral type. The focus is on three subsystems – household, firm and state settings – and the intrinsic behavioral types that are associated with these, namely social sharing, profit maximization, and rent acquisition, respectively. A fourth prototype is proposed.

In this paper, we deduce and support the positioning of country groups along the prototype systems by empirical evidence and compare these with CSES literature on the varieties of capitalism. We also address the question as to why and how different paths emerged for alternative systems, their comparative economic performances, and their future global outlooks in the context of projected displacements of current leading countries by newcomer leading countries which possess different economic systems and different behavioral profiles.

* Tel.: +31 180665432.
E-mail address: cohen@ese.eur.nl.

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1. Introduction

There are subtle differences between (a) the diligent study of one specific economic system, and (b) the comparative study of several different economic systems. A brief literature review suggests that the outstanding scientific contributions made in (a) have not been fully utilized in developing integrative theories of differing economic systems as per (b). There are reasons for the absence of integrative approaches in the comparative studies of economic systems (CSES), but there are also promising avenues for integrative approaches toward CSES that can be outlined, applied, and usefully analyzed. This paper explores these promising avenues.

At an aggregate level, economists have commonly distinguished between three broad economic systems that are labeled as the traditional system, the (centrally) planned system, and the (decentralized) market system. The diligent study of each of these systems in the individual countries where they apply has produced a wealth of knowledge on how each system operates, performs, is affected by and affects other aspects of the social system. The main contours of these studies are briefly reviewed below.

To start with, studies of the *traditional* system have treated a wide range of economic arrangements covering primitive society, tribal communities, family based rural farm settings, and informal sector enterprises, all of them lumped into what can be called preindustrial settings. The first major contributions on the working of the traditional system came from anthropologists. It suffices to mention Malinowski (1922) as the first to describe the institution of reciprocity as a guiding rule for the exchange of goods and services, conceived as gifts among kinship and tribesmen in Polynesia. A wave of studies of the traditional system followed soon after, and then subsided. Their conclusion is that, in traditional settings, exchange is determined in the context of institutions of reciprocity and sharing that are typical of closely knit personal relationships based on loyalty to shared kinship, community and belief. Another wave of studies was concerned with the informal economy in rural and urban areas, especially in the developing world. Among the first to coin the term was Lewis (1955). The informal economy was traditional in its sociological relations and production technology and politically non-participative. Later waves of studies launched the social economy as distinct from the private and public sectors. Among the latest of these studies is Bridge et al. (2009). Essentially, the social economy is made up of voluntary, non-profit and co-operative ventures. The motivational behavior in these socio-based economic activities is closest to social sharing, making it logical to treat contemporary social economy activities in the traditional subsystem.

Studies of the *planned* system were short-lived, starting around the initiation of Soviet plans in the 1920s and ending with the collapse of the communist regime toward the end of the century. While there is vast documentation describing the operation of the planning system, its problems and reforms in the Soviet Union and allied satellites (see, for example, Ellman, 1989, and Kornai, 1967, among many others), there are also insightful analytical works that focus on the collapse of the planned system and the economic depressions which followed. Some of these works emphasized the failures of communicating information and management incentives (see Stiglitz, 1993). Others emphasized a nationwide confidence crisis in the communist regime's ability to realize its promised expectations and the failure of the governing and managing bureaucracies to coordinate and control the acquired rent from their exclusive political role in a state-run economic system in a crisis situation (cf. Eggersston, 1990, and Cohen, 2009). It is also relevant to refer to Beck and Laeven (2006), who show that some rent-acquiring behavioral traits of the communist regime have re-emerged in ex-Soviet countries during and after their transition.

Turning to the *market* system, the study of the functioning of the market system and the history of economic thought have been tied to each other from the start. The elements of the market system that were outlined by Adam Smith (demand and supply determining prices in competitive markets, combined with utility maximization and profit maximization by consumers and producers) required refinements and extensions involving great economists including Pareto, Walras, Marshal, Samuelson, Arrow, Debreu and others, before these elements were rigorously integrated and formalized in a static general equilibrium theory of interlinked markets some three centuries later.

The growth dynamics of the market system are due to Schumpeter (1943), who saw it as being led by innovations and entrepreneurs, but retarded by the increased power of corporatism and greater