



## Chapter 2

# Re-Thinking the Role of Institutions in Neoliberalism From New Institutional Economics Perspective

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### ABSTRACT

*In an attempt to discuss neoliberalism with a reference to new institutional economics, this chapter problematizes the role of formal institutions in the neoliberal age by focusing on a specific type of formal institution, namely property rights in developing countries. New institutional economics (NIE) argues that secure property rights are important as they guarantee investments and thus, promote economic growth. This chapter discusses why the protection of property rights is weak and ineffective in certain developing countries despite their endorsement of neoliberalism by shedding light on the link between the institutional structure of the state and neoliberalism in the developing world. With the political economy perspective, the chapter aims to build a bridge between NIE and political economy, and thereby providing fertile ground for the advancement of NIE.*

### INTRODUCTION

In this chapter, we address the decay of formal institutions in neoliberalism, with a focus on property rights; and discuss why protection of property rights is weak and ineffective in certain developing countries that have embraced neoliberalism. In contrast to the existing literature that associates economic development

DOI: 10.4018/978-1-7998-0333-1.ch002

with democracy (Przeworski et al., 2000; Acemoğlu & Robinson, 2012), we argue that neoliberalism can coexist with autocratic regimes. This coexistence, however, substantially transforms the role of formal institutions in authoritarian neoliberal countries in the developing world as these institutions become political tools to control the society and defend the economic interests of the ruling elites. We claim that “property rights” -one of the most essential concepts of New Institutional Economics (NIE)- will not be an exception to the rule and thus, they will be severely eroded in authoritarian neoliberal states (1). Since capitalism lies on property rights, and competition and pursuit of individual interest, this chapter highlights the inherent contradiction between the core features of capitalism and policies of authoritarian neoliberal states in the developing world.

It should be noted that this chapter limits itself to the analysis of a specific type of formal institution, namely property rights. It aims to demonstrate why property rights are violated by power holders in developing countries that are authoritarian and neoliberal at the expense of generating undesirable outcomes, such as corruption, low efficiency and capital flight. With its political economy perspective, the chapter provides a new insight into the role and functioning of formal institutions. Thus, it intends to build a bridge between NIE and political economy, thereby providing a fertile ground for the advancement of NIE. Moreover, by focusing on the institutional structure of developing countries as opposed to a few selected developed countries as in most of the existing NIE research, the chapter contributes empirically to the existing NIE literature.

In pursuit of its goals, this chapter is divided into four sections. The following section briefly reviews the role of institutions and their impact on economic growth and development in NIE literature. It also discusses why secure property rights are important for robust economic performance and it sheds light on the critical role of the state in enforcement of property rights, from the new institutionalist perspective. The second section unpacks the link between neoliberalism and political regimes in the developing world by discussing the rise of a certain type of state, known as the authoritarian neoliberal states. The third section provides a discussion on a specific type of formal institution, namely property rights, to problematize the role of formal institutions in the neoliberal age in the light of NIE thinking. The section discusses the current status of property rights with reference to several authoritarian neoliberal country cases, ranging from Russia to China, and to Indonesia. Basically, it demonstrates why secure property rights are lacking in these countries. The fourth section suggests future research directions in the NIE with regard to the protection of property rights under neoliberal authoritarian states in the forthcoming period. Finally, the chapter concludes by reminding that developing countries, which combine authoritarianism with neoliberalism can achieve economic growth. These countries, however, will be prone to economic stagnation in the medium and long run.

## **BACKGROUND: INSTITUTIONS IN NEW INSTITUTIONAL ECONOMICS**

In simple terms, NIE aims to explain what institutions are, how they arise, what purposes they serve, how they change and how they can be reformed (Klein, 1998). It diverges from neoclassical assumptions by arguing that individuals have incomplete information and bound by rationality. Thus, for new institutionalists, individuals create institutions to reduce the risk stemming from uncertainty about unforeseen events and outcomes, and to lower the transaction costs induced by efforts to acquire information (Menard & Shirley, 2005). While NIE borrows from various social science disciplines, such as law, sociology, anthropology and political science, its primary language is economics.

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