NOLEGEIN Journal of
Entrepreneurship Planning, Development and Management

ISSN: 2581-3900
Volume 5, Issue 1, 2022
DOI (Journal): 10.37591/NJEPDM

http://mbajournals.in/index.php/JoEPDM/index

Review NJEPDM

The Relevance of New Institutional Economics for the Indian Economy

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Abstract

The rules of the economics game included both governmental institutions and policy. The fundamental characteristics of a government, such as whether the rule of law is upheld, property rights are maintained, and taxes are applied consistently and fairly, are determined by the policies established by the government. An economy with strong institutions can endure the odd bad policy, but a strong economy cannot have weak institutions. On the relative weight of the factors and circumstances that influence whether a country is prosperous or impoverished, several economists had divergent opinions. They concentrated on the so-called "good institutions," which motivated people to put in hard effort, develop their economies, and so benefited. But the crux of the matter was that it only focused on understanding economic institutions as they currently stand. Hence, this was where the concept of new institutional economics came into the picture. While the Keynesian macroeconomics has been a major factor in the growth, development, and distribution issues that the Indian economy has encountered, the planners and intellectuals of the Indian economy have not seen the term New Institutional Economics (NIE) as being pertinent. The NIE uses comparative institutional analysis, which distinguishes this economics from conventional classical economics. The welfare of the populace would result from the distribution of resources in an economically efficient manner. A suitable institutional framework must be developed, nevertheless, in order to make the welfare economy more effective and community-focused.

Keywords: New institutional economics, Keynesian, economic institutions, welfare, Indian economy, development, Ease of doing business

INTRODUCTION TO NEW INSTITUTIONAL ECONOMICS

Both governmental policies and institutions are part of the economics game rules. Governments constantly establish policies, and while many are long-term, others are short-term responses to short-hand, determine its fundamental features, such as whether the rule of law is upheld, property rights are maintained, and taxes are applied consistently and fairly. A robust economy can withstand the occasional bad policy, but it cannot be strong if its institutions are weak. Different economists hold opposing viewpoints on the proportional importance of the conditions and elements that determine whether a country is wealthy or impoverished. They concentrate on so-called "good institutions," which motivate people to put in hard effort, develop their economies, and so benefit both themselves and their countries. What has been talked about is merely an understanding of economic institutions as it is. What is now emerging is the concept of new institutional economics or as abbreviated NIE, which has become relevant to current economic conditions of

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Received Date: July 18, 2022
Accepted Date: August 01, 2022
Published Date: August 17, 2022

Citation: Siddharth Das, Dhawal Mehta. The Relevance of New Institutional Economics for the Indian Economy. NOLEGEIN Journal of Entrepreneurship Planning, Development and Management. 2022; 5(1): 27–31p.

the world and in particular to a developing nation. Around 1980, or five years after Oliver E. Williamson first used the phrase "new institutional economics," it began to be used more frequently. Before economists utilized it in the topics or titles of their articles, it took another three to four years [1].

The New Institutional Economics (NIE) sought to understand the social, political, industrial, and commercial institutions that governed our daily lives. It wanted to explain what institutions were, how they were formed, what purpose they served, how they changed, and how they might be reformed. NIE is an interdisciplinary enterprise. It borrows from various social science disciplines and it focuses on collective rather than on individual action. It emphasized empirical observation over deductive reasoning. According to R. C. O. Mathews, there were two propositions as far as NIE was concerned. First, “institutions matter” and second, “determinants of institutions are susceptible by the tools of economic theory” [2]. The latter proposition is what distinguishes the NIE and institutions did matter. The body of research on NIE is growing quickly, and it is having an increasing impact on fields including economics, political science, law, sociology, growth and development, and industry. It is gradually gaining deep theoretical insights that are important for developing and implementing policies. It has become a standard where various economists have come together sharing a common ground intellectually that institutions mattered. Attention needed to be given to the relationship between the institutional structure and economic behavior as the determinants of institutions can be evaluated with the help of economic theory.

OBJECTIVE

The purpose of the paper is to examine the relevance of New Institutional Economics.

METHODOLOGY

The write-up is purely a review article revolving around the concept based on information gathered.

NEGLECT OF NIE IN INDIAN POLICY FRAMEWORK

The problem faced by the Indian economy regarding growth, development, and distribution has mainly been in the context of Keynesian macroeconomics. ‘New Institutional Economics’ (NIE) as a term was created by Oliver E. Williamson along with the contribution by others in the field has not been considered relevant by the Indian economy planners and thinkers. This economics is different from mainstream classical economics in that the NIE relied on comparative institutional analysis. It also differs from traditional welfare economics, which frequently contrasted actual results with the idealized standard of perfectly competitive general equilibrium [3]. NIE is likely to be relevant to India because the Indian economy is now mixing Keynesian macroeconomics with newly emergent welfare economics. Welfare economics is all about the allocation of goods and resources in a manner that promoted social welfare. Economically efficient distribution of resources would lead to the well-being of the people. However, we are still struggling to create an appropriate institutional framework to make our welfare economy more effective and grass-root-oriented.

INSTITUTIONS DO MATTER

Institutions do matter because they are important to economic development besides providing evidence as fodder for the arguments. It argued that it supports economic development through four expansive channels, namely, the determination of the costs of economic transactions, the determination of appropriate return to investment, the determination of the level of oppression and expropriation, and the determination of the level of an environment conducive to cooperation and heightened social capital. The evidence can be derived from literature, a comparison of countries, and examples at the micro-level. The institutional environment creates the foundation for human action, and institutions established the constrained range of options available to people. Institutional restraints covered both what people were not allowed to do and/or what allowed them to do certain things. For example, the Indian caste and class system came in the way of several remarkable economic institutions. The Indian bureaucratic system developed over several decades still had to come up with appropriate institutional culture to influence its several welfare programs which showed serious leakages in their functioning. Tightening bureaucratic rules was not a solution to our institutional problems. We required a new institutional ethos. It is important to note that there is still disagreement over the specifics of the NIE. There is a transaction cost method in NIE that is focused on private goods and includes agency, transaction cost, and property rights economics (or contract). The theory of collective action focused on both tangible public goods like pollution control or roadways as well as abstract public goods like greater wages, higher prices, regulations, reduced tax rates, or policy rules. The two general approaches in the evolving field of NIE were complementary and no single approach was referred to, or more relevant than other approaches. If one approach failed to produce results, the other approach may be found more suitable to resolve certain institutional problems.

WIDENS THE ECONOMIC THINKING

Since it removed some of the rigid presumptions of traditional economics regarding the motivations of decision-makers and the facts at their disposal, many economists saw this as enlarged economics. By doing so, the study of economics would be expanded to take into account political events and the development of institutions. The NIE draws attention to the critical role that government administrative capacity plays in influencing both the NITI Aayog's operations and the institutional climate for business (2021). The National Institution for Transforming India, or NITI Aayog, is known as the Policy Commission in Hindi [4]. It served as the Government of India's principal think tank for public policy. It is the central organisation in charge of "catalysing" economic growth and fostering cooperative federalism by incorporating the State Governments of the nation into the formulation of economic policy. It could be useful to discuss why bureaucracies functioned effectively or poorly as well as how ineffective and corrupt bureaucracies could be changed or removed.

The new institutionalists have focused their attention on two key problems which are highly relevant for India's mostly dysfunctional institutional structures. These two problems were concerned with:

i. The choice of the best institutional structure from a set of alternatives, and
ii. The design of the ideal structure. Here we present a case of how India urgently needs to design institutions and their structures to start new enterprises within the time limit of one or two months.

EASE OF DOING BUSINESS (EODB) IN INDIA

If anything that holds back individual businesses or investors is the cumbersome red tape. In other words, sustainability suffered affecting an economy's ability to grow. Economic freedom to do business was closely related to economic development and a flourishing private sector. In turn, it eliminated poverty with the pursuit of shared prosperity. NIE can provide powerful analysis and prescriptions in the area of ease of doing business in India which ranks low compared to other countries despite its improvement in 2019. The World Bank Group developed a ranking system called the Ease of Doing Business (EoDB) index. Higher rankings in the index correspond to a lower numerical value indicating better business rules and greater property rights safeguards. It looks into 12 areas of business regulation from where it aggregates information to give a ranking [5].

India was placed 63rd out of 190 nations in the "Doing Business 2020: World Bank Report" [6]. The Indian government began a comprehensive Programme of regulatory reforms in 2014 with the goal of facilitating business operations there. The initiative is a significant contribution to the attempt to improve the business climate. India has improved by 67 rankings in three years, placing it among the top 10 improvers for the third consecutive year. India has become one of the most alluring locations, both for investments and for conducting business. According to the "World Bank's Ease of Doing Business Ranking 2020," India moved up 79 spots, from 142nd in 2014 to 63rd in 2019.

The government has made dramatic progress in improving India’s Ease of Doing Business ranking, but the World Bank has thrown a new challenge by adding another criterion to the ranking [7]. From the next ranking onwards, the World Bank will include 'procurement' as one of the criteria for rating countries' Ease of Doing Business. "Procurement is a key indicator of the efficiency of a government," said Junaid Kamal Ahmad, World Bank's Country Head for India. He was all praise for India's efforts and rapid rise in the EoDB rankings in recent times [8]. While the world economies strive to improve their EoDB rankings, the same is also a measure to highlight a nation's attractiveness to foreign enterprises. "Building the state's capability for efficient procurement was a key objective of World Bank", Junaid Kamal Ahmad added. In this light, the pursuit of NIE concepts and observations, taking into account the added criterion, can further help improve India’s ranking in the EoDB index.

REMOVING INSTITUTIONAL CONSTRAINTS

An economic explanation of the evolution of economic structure and performance was the goal of American economist Douglas North. He began by making the straightforward observation that norms of conduct are necessary for human collaboration [9]. For example, institutional constraints, which define the opportunity for individuals, redeem the uncertainty of human interactions and the cost of cooperation that are very high in India. A general account of the connection between the polity and the economy is one of the significant contributions that NIE can make. The Indian economy and the polity have no notable insights in understanding the interactions between them. In other words, a tight institutional framework hampered the expansion of the Indian economy, and its growth cannot be accelerated without its removal as part of the political process. NIE analyses the institutional environment to understand the economic situation, which is why India should use this newly discovered methodology and work on why it had an unacceptable number of loss-making public sector enterprises. Specific actions under the NIE can guarantee the nation's evolutionary progress and can reduce the hazards to India's economy and social stability if the status quo is maintained. India also needs to go through institutional environmental analysis evolved by the NIE approach to enquire into formal and informal institutional constraints that come in the way of institutional development. One can take the Russian example on similar lines; the country also faced institutional issues because of its focus on political stability over development. The Russian economy is currently and strictly limited by its institutional framework, within which it was impossible to expect the annual GDP growth rate to exceed 2%. For them to develop an economic program was relevant now more than ever, and they will have to choose from different options that are fundamental. One of the prominent options was for the elite and the government to come to an agreement on changes to the institutional framework that would re-establish investor confidence and ignite the fundamental drivers of economic growth [10]. There are numerous instances in history where nations have chosen political stability over progress, a decision for which they eventually paid a price by becoming outsiders to the rest of the world [11]. There are instances of nations when elites and leaders undertook significant institutional change, affecting their lives in the short term but resulting in a nation that was significantly richer and more powerful in the long term (such as China under Deng Xiaoping). The current state of affairs in the Russian economy demonstrated that attempts to resurrect economic growth without altering the institutional framework were futile and will actually necessitate taking the action on the options. In India, a rigid institutional structure is impeding economic progress, and this structure must be altered as part of the political process for growth to be more rapid. NIE might ignite further development after analyzing the institutional environment.

CONCLUSION

The emergence of a new concept by the name of 'New Institutional Economics' is creating waves in the economic planning world. It sought to understand various institutions that governed the daily lives of the public. It also sought to explain the "what" and "hows" of the institutions in the country. NIE is an interdisciplinary enterprise that applied various social science disciplines focusing on collective action. It centers on empirical observation while discarding deductive reasoning. It is steadily accumulating qualitative theoretical insights for policy formulation and its implementation. It has assumed a standard where various economists share a common ground intellectually regarding the importance of institutions. The relationship between the institutional structure and economic behavior is where attention needed to be given as the determinants of institutions can be evaluated with the help of economic theory. Apart from this, when we consider corporate governance, it is seen as a major variable influencing a growth scene of an economy because best practices reduced the risk for not just the investors, but also improved financial performance. However, the problem of corporate governance was attracting growing attention in India and should apply the lessons coming from NIE which challenged the efficiency of hierarchical power within one organization. There was a need to explore further NIE's institutional theory of change. India cannot progress simply based on a mixed economy and/or welfare economy. It is in the working of economics and political institutions that India was found wanting. Despite brilliant economic planners backed by the political elite, the Indian economy is not going further in the area of distributive justice in the country.

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