Preface and acknowledgements

After about a decade in academics and about two decades in the profession, I felt an overwhelming need to introduce a modified development economics course into the economics curricula. Upon designing a course entitled *Institutions and Economic Development*, which I started teaching in 2003 at Bilkent University, in Ankara, Turkey, the urge to write this book followed. In addition to offering a fresh approach to development economics for economics students, the material covered in this book is expected to be of interest to economic policy makers.

Though the subject of development has always been of great importance to economists, earlier theories of economic development have generally lost their explanatory power, and hence appeal, in the face of the diverse development experiences of the last few decades. These changes seemed to result in many economics departments dropping economic development courses from their curricula. Meanwhile, what appeared to dominate the development literature, upon many disappointing experiences with import-substitution industrialization (ISI) strategies and outward-oriented policies, was the theory of new institutional economics (NIE).

The literature of NIE was initiated by Ronald Coase (1960) and further established by Oliver Williamson (1985) and Douglass North (1990 and 2005); it has since been significantly contributed to by an increasing number of scholars, covering institutional economic history, property rights theory, transaction cost theory and contract theory. Several other scholars have also made influential contributions to the understanding of the role of institutions in economic
development, though their work is not framed as part of NIE; some of the most prominent of these scholars are Mancur Olson and Masahiko Aoki, whose approaches to the subject have been via collective action theory and game theory, respectively.

In view of the essential role of the institutional perspective in understanding economic development, this book selectively discusses the leading theoretical contributions of the last few decades to the highly interwoven literature of institutional economics and economic development. The perspective of this book can thus be described as ‘modified’ or ‘new’ development economics (NDE).\(^1\) NDE can be considered a synthesis of the theories of collective action and NIE, which complement each other greatly in understanding the dynamics of institutional change and the dialectical relationship between institutions and economic development. Daron Acemoglu, Avner Greif, William Easterly, Timur Kuran, Jeffrey Nugent and Dani Rodrik, among several others, have all approached the question of economic development from an institutional perspective and hence can be listed among the significant contributors to NDE.

My interest in the relationship between macroeconomics and institutions dates back to my doctoral studies during which I had the opportunity to benefit from Mancur Olson’s teachings on the theory of collective action. His book, *The Rise and Decline of Nations* (1982), provided the main focus of the graduate-level macroeconomics course I took, which exposed his students to his visionary approach to understanding the diverse development phenomena across countries, based on the roles of incentives and interest-group activities. My first involvement in institutions-related research was through a World Bank project that investigated the measurement of central bank independence and its effects on inflation. This study was published in the September 1992 issue of the *World Bank Economic Review*. My doctoral thesis, which investigated the role of institutions on the causal relationship between inflation and
budget deficits, also sprung from this study and was eventually published in the October 2003 issue of *Contemporary Economic Policy*.

Working at the World Bank while working on my doctoral thesis exposed me to a variety of macroeconomic and development issues in countries all around the world, an extremely valuable experience for a scholar in my field. The years I was at the World Bank (1989–95) coincided with the aftermath of hyperinflations in Latin America and Israel, the breakdown of the Union of Soviet Socialist Republics, the transition to market economies in Eastern Europe and Central and Western Asia, and the pursuant economic and financial reforms and restructurings. Those were the years when the World Bank was at one of the heights of its influence on economic development. My last position in the World Bank was in the sub-Saharan Africa region, which led to my involvement in the OECD project entitled *Conflict and Growth in Africa*.

The above background and experiences increased my interest in design and outcomes of macroeconomic institutions; my academic work has therefore always had an institutional touch. Exploring policies’ effects on macroeconomic outcomes would be futile without an institutional perspective because policies have their desired impact only when the appropriate set of institutions is in place, and not necessarily otherwise. Economic institutions, however, may also be induced via policies, indicating a complex and dynamic relationship between economic policy, economic performance and institutional evolution.

The central theme of this book is the exploration of the elements that affect the dynamics of the economic and institutional development nexus. Given that the market mechanism cannot solve all economic problems by itself, defining the role of government in regulating markets and providing public goods is an essential question of development economics. Economic and political systems largely shape the nature of interest groups which in turn, through the
formation of institutions, affect the relationships between people, governments and markets. With this in mind, rather than focusing on the question of refining neoclassical theory with the additional ingredient of a network of institutions at the service of markets, this book conjectures that with regard to the dynamics between institutions and economic development, the sum is more than its parts; it is these dynamics that breed new economic mechanisms and paradigms.

Building on the theoretical framework of NDE, this book reports findings from empirical work on the economic causes and consequences of macr...